90-13

No. _____

FILED

JUN 29 1990

JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

OHIO STUDENT LOAN COMMISSION,

Petitioner,

v.

LAURO F. CAVAZOS, Secretary of The United States Department of Education, *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

---

PETITION FOR WRIT OF CERTIORARI

ANTHONY J. CELEBREZZE, JR.
Attorney General of the State of Ohio

KEVIN L. SHOEMAKER*
LINDA F. MOSBACHER
Special Counsel to the Attorney General
BERRY & SHOEMAKER
88 East Broad Street
Suite 1100
Columbus, Ohio 43215
(614) 464-0100

LAWRENCE J. MILTNER
Assistant Attorney General
Ohio Student Loan Commission
309 South Fourth Street
Columbus, Ohio 43215
(614) 644-6557

Attorneys for Petitioner

**Counsel of Record*

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTIONS PRESENTED

1. Do the required transfer of reserves from the Ohio Student Loan Commission to the United States Department of Education and the canceling of reinsurance claims pursuant to 20 U.S.C. §1072(e)(1) constitute a taking of property in violation of the Taking and Due Process Clauses of the Fifth Amendment to the United States Constitution?

2. Do the required transfer of reserves from the Ohio Student Loan Commission to the United States Department of Education and the canceling of reinsurance claims pursuant to 20 U.S.C. §1072(e)(1) violate Section 4 of the Fourteenth Amendment to the United States Constitution?

LIST OF PARTIES IN THE COURT OF APPEALS

The parties in this matter are Petitioner, the Ohio Student Loan Commission and Respondents, United States Department of Education and the Secretary of the United States Department of Education. The Attorney General of Michigan filed an *amicus curiae* brief in support of OSLC's position.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
LIST OF PARTIES IN THE COURT OF APPEALS	ii
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	3
A. The History and Operation of the Guaranteed Student Loan Program	3
B. The 1987 Amendments	5
C. Proceedings Below	7
REASONS FOR GRANTING THE PETITION	10
A. The Questions Presented Affect The Entire Guaranteed Student Loan Program	10
B. The Court of Appeals Decision allows Congress To Take OSLC's Property Without Just Compensation	13
C. The Court of Appeals' Decision Constitutes a Questioning of The Public Debt	21
CONCLUSION	23

TABLE OF AUTHORITIES

CASES	Page
Amen v. City of Dearborn, 718 F.2d 789 (6th Cir. 1983), *cert. denied*, 465 U.S. 1101 (1984)	13
Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41 (1986)	18,19
Colorado v. Cavazos, No. 88-C-2073 (D. Col. filed Dec. 22, 1988)	10
Connecticut Student Loan Foundation v. Cavazos, No. H89-182 (D. Conn. Jan. 10, 1990)	10
Connolly vs. Pension Benefit Guaranty Corp., 475 U.S. 211 (1986)	9,19,20
Dayton-Goose Creek Railway v. United States, 263 U.S. 456 (1924)	13
Delaware v. Cavazos, 723 F. Supp. 234 (D. Del. 1989)	10
Education Assistance Authority v. Cavazos, ___ F.2d ___, No. 89-5393 (8th Cir. Apr. 10, 1990)	10
Georgia Student Fin. Commission v. Cavazos, No. 1:89-CV-160-MH (N.D. Ga. filed Jan. 29, 1989)	10
Great Lakes Higher Education Corp. v. Cavazos, 711 F.Supp. 485 (W.D. Wisc. 1989), *appeal pending*, No. 89-2748 (7th Cir.)	10
Indiana v. Cavazos, No. IP 89-125-C (S.D. Ind. Jan. 29, 1989)	10
Iowa v. Bennett, No. 88-142-B (S.D. Iowa filed Jan. 6, 1988)	10
Lynch v. United States, 292 U.S. 571 (1934)	15,16,17,18,19
Maine State Board of Education v. Cavazos, No. 88-0273-B (D. Me. filed Nov. 23, 1988)	10
Massachusetts Higher Education Assistance Corp. v. Cavazos, No. 89-1325-K (D. Mass. filed June 5, 1989)	10

Table of Authorities Continued

Page

Michigan Higher Education Authority v. Cavazos, No. L89-400/8CA (W.D. Mich. filed Dec. 15, 1989) 10

Missouri Coordinating Board of Higher Education v. Cavazos, No 88-4576-CV-C9 (W.D. Mo. filed Dec. 15, 1988) 10

National R. Passenger Corp. v. A.T. & S.F.R. Co., 470 U.S. 451 (1985) 22

New Hampshire Higher Education Assistance Foundation v. Cavazos, No. C88-4-56-D (D.N.H. filed Nov. 16, 1988) 10

Ohio Student Loan Commission v. Cavazos, 709 F. Supp. 1411 (S.D. Ohio 1988), *rev'd*, 900 F.2d 894 (6th Cir. 1990) 2,10,14

Ohio Student Loan Commission v. Cavazos, 900 F. 2d 894 (6th Cir., 1990) 1

Perry v. United States, 294 U.S. 33 (1935) 19,22

Puerto Rico Higher Education Assistance Authority v. Cavazos, No. 89-3069-TFH (D.D.C. filed Nov. 9, 1989) 10

Rhode Island Higher Education Assistance Authority v. Cavazos, No. 89-0015T (D.R.I. filed Jan. 9, 1989) 10

Student Loan Guarantee Foundation of Arkansas, Inc. v. Cavavos, No. LR-C-88-862 (E.D. Ark. filed Dec. 15, 1988) 10

Tennessee Student Assistance Corp. v. Cavazos, No. 389-0261 (M.D. Tenn. filed Dec. 28, 1989) 10

United States Trust Co. v. New Jersey, 431 U.S. 1, (1977) 22

Virginia State Education Assistance Authority v. United States, No. 88-0874-R (E.D.Va. filed Dec. 30, 1988) 10

Table of Authorities Continued

Page

CONSTITUTIONAL PROVISIONS STATUTES AND REGULATIONS

United States Constitution, Fifth Amendment 2,*passim*

United States Constitution, Section 4, Fourteenth Amendment 2,*passim*

Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 ..... 2,*passim*

Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 ..... 5,*passim*

20 U.S.C. §1071(a)(1)(A) 3

20 U.S.C. §1072(e) 2,*passim*

20 U.S.C. §1072(e)(1) 5,9

20 U.S.C. §1072(e)(2) 6

20 U.S.C. §1072(e)(2)(B) 7

20 U.S.C. §1072(e)(4) 5,6

20 U.S.C. §1078(b)(1)(H) 3

20 U.S.C. §1078(c)(1) 3,6,16,17,20

20 U.S.C. §1078(c)(1)(A) 4,6,22

20 U.S.C. §1078(c)(1)(B) 4

20 U.S.C. §1078(c)(6)(A)(ii) 3

20 U.S.C. §1078(c)(9) 6,7,16

20 U.S.C. §1078(f) 3,6

20 U.S.C. §1082(a)(2) 7

28 U.S.C. §1254(1) 2

28 U.S.C. §1331 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. _____

OHIO STUDENT LOAN COMMISSION,

Petitioner,

v.

LAURO F. CAVAZOS, Secretary of The United States Department of Education, *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

---

PETITION FOR WRIT OF CERTIORARI

The Attorney General of the State of Ohio, Anthony J. Celebreeze Jr., on the behalf of the Ohio Student Loan Commission, respectfully petitions this Court to issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in *Ohio Student Loan Commission v. Cavazos*, 900 F. 2d 894 (6th Cir. 1990).

OPINIONS BELOW

The April 2, 1990 opinion of the Court of Appeals for the Sixth Circuit [reprinted in the appendix to

this Petition ("App.") App. at la-16a] is reported at 900 F. 2d 894. The opinion of the District Court (App. at 17a-37a) is reported at 709 F. Supp. 1411.

JURISDICTION

The judgment of the Court of Appeals was entered on April 2, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Fifth Amendment to the United States Constitution provides in relevant part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation. (App. at 73a-74a)

2. Section 4 of the Fourteenth Amendment to the United States Constitution provides in relevant part:

> The validity of the public debt of the United States, authorized by law, . . . shall not be questioned . . . (App. at 71a-72a)

3. Sections 3001 and 3002 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36, *et seq.*, formerly codified at 20 U.S.C. §1072(e), are lengthy, and their pertinent texts are set forth in the appendix. (App. at 74a-78a).

4. Pertinent sections of the Higher Education Act of 1965, Pub. L. 89-329, 79 Stat. 1219, particularly those codified at 20 U.S.C. §1071, and 20 U.S.C. §1078, are lengthy and are set forth in the appendix. (App. at 38a-70a).

STATEMENT OF THE CASE

A. The History and Operation of the Guaranteed Student Loan Program

In 1965 Congress, as part of the Higher Education Act ("the Act") enacted provisions creating what is now known as the Guaranteed Student Loan Program ("GSLP") Pub. L. 89-329, 79 Stat. 1219, 20 U.S.C. §1071 *et seq.*, as amended. The program was designed to encourage states and non-profit private institutions and organizations to establish adequate loan insurance programs for students wishing to attend college. 20 U.S.C. §1071(a)(1)(A). Guaranty agencies guarantee the repayment of loans made by lenders to students. Petitioner, the Ohio Student Loan Commission ("OSLC"), was created by Ohio law to serve the role of Ohio guaranty agency within the GSLP.

OSLC funds its operations through six current sources of income:

> (1) An insurance premium charged to lenders [20 U.S.C. §1078(b)(1)(H)];
>
> (2) Federal reinsurance paid pursuant to contract with the Secretary [20 U.S.C. §1078(c)(1)];
>
> (3) Federal administrative costs allowances to defray a portion of the program costs [20 U.S.C. §1078(f)];
>
> (4) Collection fees for collection of defaulted loans reinsured by the Secretary [20 U.S.C. §1078(c)(6)(A)(ii)];
>
> (5) Interest earned on the investment of reserved funds; and,

(6) Fees for services provided to lenders and schools.

The subject of this lawsuit is the federal reinsurance paid pursuant to a contract between Petitioner and Respondent. In the mid 1970's, the OSLC entered into a written contract with Respondents, the United States Department of Education ("the Department") and the Secretary of the United States Department of Education ("the Secretary"), wherein the Secretary agreed to pay reinsurance to OSLC if OSLC should be required to pay its guarantee to a lender. In 1986 Congress statutorily reaffirmed the contractual right of guaranty agencies to reinsurance from the United States. 20 U.S.C. §1078(c)(1)(A).

Pursuant to its contract with the Secretary, OSLC pays a fee for reinsurance amounting each year to 0.25 percent of the total principal amount of loans upon which guarantees were issued during each particular fiscal year. Under the terms of the contract, if OSLC maintains its rate of default on all guaranteed loans at or below 5 percent, the Secretary is to pay OSLC 100 percent reinsurance. See also 20 U.S.C. §1078(c)(1)(b). A higher default rate provides OSLC with less reinsurance. This process encourages low default rates because, regardless of the percentage of reinsurance, OSLC remains obligated to the lenders at a guarantee rate of 100 percent of the defaulted loans. To its credit, OSLC has never received less than 100 percent reinsurance since the Secretary began providing 100 percent reinsurance in 1976.

As a result of its efficient, conservative operation, OSLC prevented any erosion of its reserves while simultaneously increasing its reserve strength through

the receipt of guarantee premiums and other receipts listed above. Unfortunately, OSLC's successful operation was ended when Congress enacted §3001 of the Consolidated Omnibus Budget Reconciliation Act of 1987 on December 22, 1987. Pub. L. 100-203, 101 Stat. 1330-36 (hereinafter, the "1987 Amendments"). That statute is the focus of this Petition.

B. The 1987 Amendments

Portions of the 1987 Amendments altered the Higher Education Act of 1965, limiting the amount of cash reserves that a guaranty agency could accumulate. In particular, 20 U.S.C. §1072(e)(1) arbitrarily limited cash reserves to the greater of five amounts:

> (1) Forty percent of the total amount paid by an agency on insurance claims during the preceding year;
>
> (2) 0.3 percent of the original principal amount of loans insured by the agency and outstanding at the end of such preceding fiscal year;
>
> (3) An amount which, when combined with all other parts of the total agency reserves equals 0.4 percent of the original principal amount;
>
> (4) $500,000; or
>
> (5) The amount required to comply with the reserve requirements of state law as in effect on October 17, 1986.

The Secretary was required to determine the excess cash reserves each state guaranty agency had for fis-

cal year 1986 by March 31, 1988. 20 U.S.C. §1072(e)(2). The total reduction of excess cash reserves for all agencies was limited to $250,000,000 in fiscal year 1988. 20 U.S.C. §1072(e)(4). Once the Secretary determined that an agency had excess cash reserves, he was to direct the agency to reduce the reserves:

> (A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d) of this section;
>
> (B) by withholding and *canceling* claims for reimbursement otherwise payable under §1078(c)(1) of this title;
>
> (C) by reducing the amount of payments for which application will be made by such agency under §1078(f) of this title; or
>
> (D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees, in addition to the fees required by §1078(c)(9) of this title, as proposed by the agency and agreed to by the Secretary.

20 U.S.C. §1072(e)(2). (Emphasis added). The cash recovery provisions of 20 U.S.C. §1072(e) were automatically repealed on September 30, 1989. Pub. L. 100-203 §3002, 101 Stat. 1330-38.

This legislation concomitantly amended 20 U.S.C. §1078(c)(1)(A), making the contractual right to reinsurance against the United States for the life of the loan "subject to §1072(e)." The legislation also

amended 20 U.S.C. §1078(c)(9), making the payment to the Secretary of the reinsurance fee "subject to §1072(e)."

OSLC subsequently sent a letter to the Secretary dated February 1, 1988, advising that OSLC expected the Secretary to honor his reinsurance contract and also advising that OSLC regarded §1072(e) as a breach of contract and unconstitutional legislation. On February 9, 1988, OSLC received a response from the Secretary stating that the Department planned to implement §1072(e) and would take the sum of $26,075,259, the amount OSLC's reserves exceeded the minimum required by Ohio law, from OSLC. The letter directed that OSLC should choose a means of payment or one would be chosen for it by the Secretary. OSLC refused to choose a method for reducing reserves. The Secretary then chose §1072(e)(2)(B) for OSLC—the withholding and canceling of the contract payments of reinsurance.

C. Proceedings Below

Responding further to the Secretary's actions, OSLC filed a civil action in the United States District Court for the Southern District of Ohio, Eastern Division, for declaratory and injunctive relief on March 15, 1988. Jurisdiction was premised on the existence of a federal question pursuant to 28 U.S.C. §1331 and 20 U.S.C. §1082(a)(2) which specifically permit suit against the Secretary. OSLC sought a declaration that the 1987 Amendments violate the Fifth and Fourteenth Amendments of the United States Constitution. Specifically, OSLC alleged that §1072(e):

> (1) Abrogates the Secretary's contracts with OSLC;

(2) takes OSLC's property without just compensation;

(3) takes OSLC's property without due process of law; and,

(4) constitutes the questioning of the public debt authorized by law.

After unsuccessful motions by the Secretary to dismiss the complaint and to transfer the case to the District Court for the District of Columbia, on September 8, 1988, the Secretary advised OSLC by letter that he would implement §1072(e) by canceling contractual payments on pending and future reinsurance claims [including claims predating §1072(e)] until the Secretary had recognized a savings of $26,075,259. On September 9, 1988, OSLC moved the District Court for a temporary restraining order and a preliminary injunction. The District Court conducted a hearing in chambers on September 9, 1988. The Secretary argued that the loss to OSLC was purely economic and not irreparable. The District Court agreed, denied the application for the temporary restraining order, and set a hearing on the application for a preliminary injunction. The hearing on the preliminary injunction was combined with the trial on the merits. The case proceeded to trial on November 7, 1988.

On December 19, 1988, the District Court issued its opinion and order declaring that the 1987 Amendments violate the Fifth and Fourteenth Amendments to the United States Constitution to the extent that they operate to withhold funds from OSLC on reinsurance of loans originated prior to December 22, 1987. The order enjoined the Secretary from further

withholding and canceling reinsurance and ordered him to pay OSLC reinsurance wrongfully withheld. The Secretary then moved to suspend the injunction and for relief from judgment. On February 17, 1989, the Secretary also appealed the District Court's December 19, 1988 opinion and order to the United States Court of Appeals for the Sixth Circuit. On March 10, 1989, the District Court denied the Secretary's motion to stay the injunction and his motion for relief from judgment.

The Court of Appeals reversed the District Court's decision. Specifically, the Court found that the Secretary's actions taken pursuant to §1072(e)(1) did not constitute a taking of property in violation of the Fifth Amendment because the excess reserves did not constitute private property, and even if they did, there could be no taking by the federal government. *Connolly vs. Pension Benefit Guaranty Corp.*, 475 U.S. 211, (1986). Because the court found that the contract between OSLC and the Secretary was not private property, the Secretary's actions did not constitute a taking in violation of the Fifth Amendment. The Court of Appeals concluded that the agreement between the Secretary and OSLC amounted to a sharing of governmental authority and that the contract was only a codification of a cooperative relationship. Consequently, the Court of Appeals found no breach of contract and no violation of either the due process clause or Section 4 of the Fourteenth Amendment.

REASONS FOR GRANTING THE PETITION

A. The Questions Presented Affect The Entire Guaranteed Student Loan Program

This case presents significant public policy issues regarding the relationship between the federal gov-

ernment and all the guaranty agencies participating in the Guaranteed Student Loan Program.[1] The Court of Appeals has held that OSLC is administering a federal program on behalf of the Secretary and that OSLC has no property interest in its reserve fund. Likewise, the Court of Appeals determined that

---

[1] *See Student Loan Guarantee Foundation of Arkansas, Inc. v. Cavazos*, No. LR-C-88-862 (E.D. Ark. filed Dec. 15, 1988); *Colorado v. Cavazos*, No. 88-C-2073 (D. Col. filed December 22, 1988) (consolidated with suits filed by Montana, New Mexico, North Dakota, and Utah); *Connecticut Student Loan Foundation v. Cavazos*, No. H89-182 (D. Conn. Jan. 10, 1990) (Slip Op.); *Delaware v. Cavazos*, 723 F. Supp. 234 (D. Del. 1989); *Georgia Student Fin. Commission v. Cavazos*, No. 1:89-CV-160-MHS (N.D. Ga. filed Jan. 26, 1989); *Indiana v. Cavazos*, No. IP 89-125-C (S.D. Ind. Jan. 29, 1990) (Slip Op.) (reversing the Secretary's actions and remanding for further proceedings); *Iowa v. Bennett*, No. 88-142-B (S.D. Iowa filed March 15, 1988); *Maine State Board of Education v. Cavazos*, No. 88-0273-B (D. Me. filed November 23, 1988); *Massachusetts Higher Education Assistance Corp. v. Cavazos*, No. 89-1325-K (D. Mass. filed June 5, 1989); *Michigan Higher Education Authority v. Cavazos*, No. L89-400/8CA (W.D. Mich. filed Feb.13, 1989); *Missouri Coordinating Board of Higher Education v. Cavazos*, No. 88-4576-CV-C9 (W.D. Mo. filed Dec. 15, 1988); *New Hampshire Higher Education Assistance Foundation v. Cavazos*, No. C88-4-56-D (D.N.H. filed Nov. 16, 1988); *Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (S.D. Ohio 1988), *reversed*, 900 F.2d 898 (6th Cir. 1990); *Puerto Rico Higher Education Assistance Authority v. Cavazos*, No. 89-3069-TFH (D.D.C. filed Nov. 9, 1989); *Rhode Island Higher Education Assistance Authority v. Cavazos*, No. 89-0015T (D.R.I. filed Jan. 9, 1989); *Education Assistance Authority v. Cavazos*, ___ F.2d ___, No. 89-5393 (8th Cir. 1990) (South Dakota); *Tennessee Student Assistance Corp. v. Cavazos*, No. 389-0261 (M.D. Tenn. filed Dec. 29, 1989); *Virginia State Education Assistance Authority v. United States*, No. 88-0874-R (E.D.Va. filed Dec. 30, 1988); *Great Lakes Higher Education Corp. v. Cavazos*, 711 F.Supp. 485 (W.D. Wis. 1989), *appeal pending*, No. 89-2748 (7th Cir.).

OSLC's contractual rights did not rise to the level of property subject to protection under the Fifth Amendment to the United States Constitution. This ruling, as will be shown, is contrary to the sound reasoning of numerous decisions from this Court.

These issues have touched the pulse of the statutory scheme and legal framework that Congress established under the Act. Neither this Court nor any appellate court has ever addressed the legal framework of the GSLP before, although the program has operated for 25 years. The GSLP has been the primary vehicle for delivery of post secondary educational credit in this country and its stability is now threatened.

OSLC, like all guarantee agencies has a separate contract with lenders for the guarantee and a separate contract with the United States for reinsurance. There is no direct contractual relationship between lenders and the United States. Whether the United States pays reinsurance or not, OSLC must meet its contractual commitment to the lender. OSLC has, in the past, managed this risk by contracting with the United States for reinsurance and managing its reserves at a level appropriate to meet its guarantee commitments to lenders. What the Court of Appeals' decision has done is to fundamentally affect this basic framework by deciding: 1) that OSLC has no property interest in its reserve funds, leaving OSLC unable to control its risk through management of its reserve level since the reserves are subject now to taking by the United States for deficit reduction without fear of Fifth Amendment repercussions; and 2) that OSLC's contract for reinsurance does not rise to the level of property protected from taking under the

Fifth Amendment, again making cancellation of OSLC's contract right to reinsurance free of Fifth Amendment repercussions. The Appellate Court's decision leaves OSLC and other guaranty agencies under the GSLP unable to control reserves and unable to rely on reinsurance after, in OSLC's case, commitment to lenders on over two billion dollars in guarantees. Therefore, this decision is highly destabilizing to an important national program.

As can be seen, the Court's ruling in this case will have an unprecedented chilling effect upon the GSLP on a national basis. The GSLP has provided millions of students with the opportunity to attend post-secondary educational institutions. Success of the program has always been based upon performance by guaranty agencies. Those agencies operating efficiently by keeping default rates low and collections and loan volume high have increased the level of their reserve funds. Those agencies operating inefficiently by allowing high default rates and low collections and loan volume have decreased the level of their reserve funds. By allowing the United States to alter its commitments to guaranty agencies, the Court of Appeals' decision now allows the United States to take reserve funds and place efficient, solvent, high-reserve agencies, like OSLC, in the same position as inefficient, low-reserve agencies, thus destroying the incentive to operate efficiently. This has the dual effect of increasing the cost of the program for the taxpayers and limiting the amount of money available for loans to needy students.

B. The Court of Appeals Decision Allows Congress To Take OSLC's Property Without Just Compensation

The Court of Appeals' decision is inconsistent with numerous cases decided by this Court, and there are inconsistencies within the decision itself. While the court adopted many of the principles espoused by this Court, it has misapplied these principles in this case.

For example, the Court of Appeals stated that OSLC possesses some rights of ownership in the reserve fund and is not merely a federal agent. The court further stated that, for purposes of the Fifth Amendment, the definition of property is broad, encompassing the entire group of rights incident to ownership. *Amen v. City of Dearborn*, 718 F.2d 789, 794 (6th Cir. 1983), *cert. denied*, 465 U.S. 1101 (1984). Yet the court determined that OSLC's reserve fund is not protected by the Fifth Amendment. Instead, the Court of Appeals stated that OSLC's role was akin to that of a trustee. See *Dayton-Goose Creek Railway v. United States*, 263 U.S. 456 (1924). Such an analysis is patently incorrect.

This Court's decision in *Dayton-Goose Creek* concerned a unique regulatory scheme involving public railroads. The statute in *Dayton-Goose Creek* explicitly established a trust for future railroad earnings. No such language appears in the Act. Moreover, the clear expectation of any company subject to the trust provisions of the statute in *Dayton-Goose Creek* was that the income would be held in trust. In the present case there was no such expectation. Only after Congress realized that money had to be confiscated from some source to meet the Gramm-Rudman cuts did Congress focus on the guaranty agency reserves. Unfortunately, over one-fifth of all of the funds came

from the reserves of OSLC and the Virginia guaranty agency.[2]

The Court of Appeals also determined that the Secretary is transferring funds not from a state program but from a federal program with a state administrator. However, the language of the Act is in direct contravention of this finding. The purpose of the Act is to "encourage States and nonprofit private institutions and organizations to establish adequate loan insurance programs. . . . " 20 U.S.C. §1071. The purpose of the Act was not to create state administrators of federal trusts. Each agency was to function independently through a contractual relationship with the federal government. The entire statutory scheme of the Act was premised on contractual incentives designed to keep default rates low and collections and loan volume high.

The Court of Appeals characterized OSLC as an middleman simply passing funds from the Secretary to lenders. Were this true, there would not be such a great disparity in the level of reserve funds among guaranty agencies. As the District Court found from the facts at trial, OSLC's funds increased because of its efficient operations. *Ohio Student Loan Commission v. Cavazos*, 709 F. Supp 1411 (1989). The entire statutory scheme of payments to the guaranty agencies operates on the assumption that efficient agencies will be rewarded. By keeping default rates at 5% or

---

[2] Although the 1987 Amendments called for a reduction "excess" funds by $250,000,000, the bulk of the reduction came from efficient agencies. OSLC lost over $26,000,000 and the Virginia State Education Assistance Authority lost approximately $20,000,000.

below, the level of reimbursement remains at 100%. If the agency's default rate exceeds 5%, the agency's reinsurance reimbursement percentage drops and its reinsurance fee increases from .25% to .50%. Likewise, 30% of all collections on defaulted loans which have been reinsured by the Secretary may be retained by the agency, encouraging vigorous collection efforts. All of these elements indicate that efficient agencies such as OSLC were intended by Congress to be compensated for their careful operations, thereby fostering increased lender participation to the benefit of student borrowers. If these funds are not the private property of OSLC, all of these fees and payments are an expensive ruse. Congress could not have intended such a meaningless exercise.

In addition, the Court of Appeals has dangerously departed from this Court's decision in *Lynch v. United States*, 292 U.S. 571 (1934), by determining that certain contracts with the federal government concerning operations of federal programs do not create contractual rights rising to the level of property protected from a "taking" under the Fifth Amendment. In *Lynch*, this Court was faced with a challenge by a beneficiary under a policy for yearly renewable term insurance issued by the United States during World War I pursuant to the War Risk Insurance Act of October 6, 1917. The Plaintiff's insured had died but the claim for payment was refused by the United States. The United States demurred to the petition on the grounds that the Court was without jurisdiction to entertain the suit because the consent of the United States to be sued had been withdrawn by the "Economy Act." While the United States had not entered into these contracts for a business purpose

or financial gain, this Court nonetheless determined that "[v]alid contract rights are property, whether the obligor be a private individual, a municipality, a State, or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment." *Lynch, supra*, at 571. This Court held that Congressional enactment had taken the property rights of the beneficiary in violation of the Fifth Amendment. This Court further determined that Congress could not reduce expenditures by repudiating and abrogating the contractual obligations of the United States. The present circumstances are identical to the circumstances in *Lynch*.

In this case, the existence of a contract is not disputed. The terms of the written agreements between OSLC and the Secretary call for the payment of reinsurance by the Secretary. Section 1078(c)(1) of Title 20 stated, prior to the enactment of the legislation here challenged, that OSLC "shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement. . . "[3] Thus, it is clear that there is a contractual right to reinsurance on each loan OSLC guarantees. In addition, since 1986 OSLC has paid a reinsurance fee to the Secretary for this reinsurance. 20 U.S.C. §1078(c)(9). The purpose of the 1987 Amendments was to reduce the Secretary's expenditures by $250 million. The Secretary has conceded that the 1987 Amendments were intended to save $250 million in

---

[3] The Decision of the District Court recognized that the Federal Government could change its conditions relative to new loans made subsequent to December 22, 1987, but refused to allow such changes for those contracts which had already been executed.

the federal cost of running the GSLP. This goal is identical to the legislative goal discussed in *Lynch*. Under authority of the 1987 Amendments, the Secretary has withheld and canceled claims for reinsurance otherwise payable under the contract referenced above.

The Court of Appeals, although citing *Lynch* for the correct proposition that valid contracts are property protected from taking under the Fifth Amendment, departed from this Court's holding in *Lynch* by choosing to view OSLC's contract with the United States as merely a codification of the cooperative relationship between federal and state agencies in the administration of the GSLP. Under the Court of Appeals' view, even though §1078 gives agencies "contractual rights," these rights do not rise to the level of property under the Fifth Amendment. Congress was therefore free to retroactively and unilaterally change contracts made prior to the 1987 Amendments without violating the taking clause of the Fifth Amendment.

The Court of Appeals attempted to distinguish *Lynch* first by stating that the statute in *Lynch* totally repealed the War Risk Insurance Act, while the 1987 Amendments merely altered the terms of the agreements. However, the Court of Appeals has failed to recognize that 20 U.S.C. §1078(c)(1) created contracts of reinsurance for the life of each individual loan. When the Secretary enforced 20 U.S.C. §1072(e), he was directed by Congress to both withhold and cancel reinsurance otherwise payable under 20 U.S.C. §1078(c)(1). Reinsurance was not just temporarily withheld pending compliance with a requirement to reduce excess cash reserves. For example, if OSLC

had paid guaranty claims to lenders out of its reserve fund without reinsurance reimbursement until it had paid out $26,075,259, but once this reduction had been achieved then called for reinsurance on these claims to be paid, i.e. no longer withheld, OSLC's reserve fund would have risen again by the amount of $26,075,259, resulting in no reduction and no budgetary savings to the United States. On the contrary, the budgetary savings could only be accomplished by doing precisely what 20 U.S.C. §1072(e) instructed: withholding *and canceling* there insurance payments altogether. OSLC has forever lost the right to reinsurance on the affected loans. This was not "merely" an alteration of the terms of the agreements. It was an abrogation of those terms that obligated the United States to pay reinsurance so that it could avoid the harsh consequences of the Gramm-Rudman-Hollings cuts. As this Court instructed in *Lynch*:

> To abrogate contracts, in the attempt to lessen government expenditure, would not be the practice of economy, but an act of repudiation.

Lynch, supra, at 580.

In essence, although it cites *Lynch* the Court of Appeals ignores *Lynch*. The Appellate Court's decision is in actuality fashioned from language in the decision of *Bowen vs. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986). In that case the Court stated:

> As Appellee must concede, the Act itself, including the original version of §418(g), created no contractual rights. *cf. Fleming vs. Nestor, supra* at 608-611; *see also National*

Railroad Passenger Corporation vs. Atchison, T. and S.F.R.Co. 470 U.S. 451, 465-470 (1985). Therefore, there is no doubt that Congress had the power to amend the section.

The Court in *Bowen* was not dealing with contractual rights created by a federal statute. Therefore, the *Bowen* decision and other decisions relating to federal programs which do not create contractual rights are inapplicable.

This Court has held that the federal government, as sovereign, has both the power to enter into contracts that confer vested rights, and the concomitant duty to honor those right. *Bowen, supra; Perry v. United States*, 294 U.S. 33 (1935); *Lynch, supra.* Although subsequent amendment of a statute may, in some instances, alter the federal government's obligations, this is not true where Congress has surrendered in unmistakable terms its right to alter the contract. *Bowen, supra*, at 41. Coupled with the fact that a debt or obligation of the United States to provide benefits for which an obligee has paid cannot be altered retroactively, the Court of Appeals decision clearly conflicts with the decisions of this Court.

The Court of Appeals also misinterpreted *Connolly vs. Pension Benefit Guaranty Corp., supra*, applying it in a manner inconsistent with the decisions of this Court. In *Connolly*, a three prong test was created to determine whether there had been a taking of property for purposes of the Fifth Amendment. The factors to be considered are:

(1) The economic impact of the regulation on the claimant;

(2) The extent to which the regulation has interfered with distinct investment-expectations; and,

(3) The character of the governmental action.

Connolly, supra, at 225.

The Court of Appeals found that none of these factors were present in this case. The Court of Appeals initially determined that the economic impact of the regulation was mitigated because OSLC could have sought a waiver from the Secretary if there had been a serious economic impact. However, the Court of Appeals has misinterpreted this element of the test. Apparently the Court of Appeals believed that where an individual or entity has sufficient funds to survive the "taking" there is no economic impact. However, there are no cases decided by this Court turning on the wealth of the party targeted by congressional action. Whether the funds are or are not "excess" should have no effect. The economic impact of the 1987 Amendments are apparent. OSLC is losing approximately half of its entire reserve fund pursuant to 20 U.S.C. §1072(e).

The second factor relates to whether there is an interference with distinct investment-backed expectations. The Appellate Court determined that OSLC had sufficient notice that there might be a change in the statute. Certainly OSLC was aware, and the District Court agreed, that a prospective change could take place. However, the Court of Appeals ignored the language of 20 U.S.C. §1078(c)(1) relating to contractual rights "during the life of the loan." That language created expectations of reimbursement during the life of any loan guaranteed prior to December

22, 1987. Likewise, the congressional mandate that contracts be executed with lenders guaranteeing 100 percent of every debt created OSLC's logical expectation that compliance with the statute would continue to lead to reimbursement on all of those loans previously made.

The third factor, the character of the governmental action, further highlights Court of Appeals' error. That court found that the government did not appropriate OSLC's assets for its own use, but was simply redistributing the funds among other guaranty agencies. Obviously the greater the excess funds, the more money taken from an agency. Accordingly, OSLC is first being required to pay for the sins of other agencies failing to properly operate their programs. Additionally, the funds which the United States does not pay by virtue of the cancellations directly affects the federal budget deficit because the equivalent amount has not been appropriated for the GSLP. Thus, the Secretary has been able to meet the Gramm-Rudman cuts even though he claims that the funds were not taken by the federal government. However, it was a "taking" that was at the very heart of the enactment of 20 U.S.C. §1072(e).

C. The Court of Appeals' Decision Constitutes a Questioning of The Public Debt

The Court of Appeals' decision summarily disposed of OSLC's argument relating to Section 4 of the Fourteenth Amendment. That section reads as follows:

> The validity of the public debt of the United States authorized by law . . . shall not be questioned.

In the present matter, there was clearly a public debt authorized by law. 20 U.S.C. §1078(c)(1)(A). The Secretary was required to pay reinsurance claims submitted by OSLC. However, the Court of Appeals simply stated that because the court found no abrogation of OSLC's contract under the Fifth Amendment, there was no violation under Section 4 of the Fourteenth Amendment.

This approach is contrary to this Court's holding in *Perry v. United States, supra*. In *Perry*, this Court determined that the right of the government to make binding contracts was a sovereign power itself and that the exercise of certain other sovereign powers did not include the power to abrogate contracts protected by Section 4 of the Fourteenth Amendment.[4] When this Court applies the analysis of *Perry v. United States*, and focuses upon the integrity of the federal government's obligations, it is apparent the Court of Appeals was incorrect and that the Fourteenth Amendment has been violated. The court did not focus upon the nature of the property involved but focused instead upon the nature of the obligation, interpreting the expression "the validity of the public debt" broadly to embrace "whatever concerns the integrity of public obligations." *Perry, supra*, at 354. The 1987 Amendments certainly affected the integrity

---

[4] *United States Trust Co. v. New Jersey*, 431 U.S. 1, 53-54 n.16 (1977) (Brennan, J., dissenting) (discussion of *Perry*, 294 U.S. 330).

In *National R. Passenger Corp. v. A.T. & S.F.R. Co.*, 470 U.S. 451, 471, n.24 (1985), this Court suggested that there may be reason, in light of its strong holdings in Perry and Lynch, to consider a stricter standard of review in examining cases where the Government acts to impair its obligations.

of public obligations because the Secretary is expressly authorized to cancel payments contractually due OSLC.

CONCLUSION

The inconsistencies between the Court of Appeals' decision and the decisions of this Court are numerous and significant. Therefore, Petitioner requests that this Court grant this Petition for a Writ of Certiorari and review the decision of the Sixth Circuit Court of Appeals.

Respectfully submitted,

ANTHONY J. CELEBREZZE, JR.
Attorney General of the State of Ohio

KEVIN L. SHOEMAKER*
LINDA F. MOSBACHER
Special Counsel to the Attorney General
BERRY & SHOEMAKER
88 East Broad Street
Suite 1100
Columbus, Ohio 43215
(614) 464-0100

LAWRENCE J. MILTNER
Assistant Attorney General
Ohio Student Loan Commission
309 South Fourth Street
Columbus, Ohio 43215
(614) 644-6557

Attorneys for Petitioner

**Counsel of Record*

APPENDIX

TABLE OF CONTENTS

	Page
April 2, 1990 Opinion of the United States Court of Appeals for the Sixth Circuit in *Ohio Student Loan Commission v. Cavazos*, 900 F.2d 894 (6th Cir. 1990).	1a
December 19, 1988 Opinion and Order of the United States District Court for the District of Ohio in *Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (S.D. Ohio 1988), *rev'd*, 900 F.2d 894 (6th Cir. 1990).	17a
20 U.S.C. § 1071 (1986 Supp.)	38a
20 U.S.C. § 1078 (1986 Supp.)	40a
United States Constitution, Amendment XIV	71a
United States Constitution, Amendment V	73a
Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36	74a

Nos. 89-3168/3238

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

OHIO STUDENT LOAN COMMISSION,
Plaintiff-Appellee,

v.

LAURO F. CAVAZOS, Secretary of the United States Department of Education; and UNITED STATES DEPARTMENT OF EDUCATION,
Defendants-Appellants.

ON APPEAL from the United States District Court for the Southern District of Ohio

---

Decided and Filed April 2, 1990

Before: KEITH, JONES and GUY, Circuit Judges.

JONES, Circuit Judge, delivered the opinion of the court, in which KEITH, Circuit Judge, joined. GUY, Circuit Judge, (pp. 15-16) delivered a separate concurring opinion.

JONES, Circuit Judge. Defendants-appellants, Lauro F. Cavazos, the Secretary of the Department of Education (DOE), and the DOE, appeal judgment and denial of Fed. R. Civ. P. 60(b) relief in this action challenging the constitutionality of certain 1987 Amendments to the Higher Education Act of 1965. For the following reasons, we reverse the grant of summary judgment.

I.

The Higher Education Act of 1965, as amended, 20 U.S.C. § 1071, *et seq.* (1982) (the Act), created the Guaranteed Student Loan Program (GSLP), which provides financial assistance to students seeking a college education. Under the GSLP, lenders — such as banks, savings and loans associations and credit unions — make low-interest loans to students. The Secretary subsidizes the loans, but the 58 state or private non-profit guaranty agencies actually guarantee payment of the loan to the lender. The guaranty agency in the matter before us, the Ohio Student Loan Commission (OSLC), then obtains reinsurance from the federal government.

The OSLC is a state agency created for the purpose of administering Ohio's student loan guaranty program. Ohio Rev. Code § 3351 (Baldwin 1988). It is authorized to enter into contracts in its own name, and the state is not liable on its debts. Ohio Rev. Code § 3351.07. Initially, the OSLC received state appropriations totalling $967,000, but this funding ended in 1967. Currently, the OSLC receives funding from several sources. First, it receives reinsurance payments or reimbursements from the Secretary for losses sustained due to defaults by student borrowers under 20 U.S.C. § 1078(c). The amount of payments varies from 80 percent to 100 percent of the total default, depending upon the agency's default rate. The OSLC has consistently recorded a default rate below 5 percent, and as such, has received reinsurance for the full amount of defaults. Second, the OSLC receives administrative cost allowances from the Secretary pursuant to 20 U.S.C. § 1078(f). This federal payment is to compensate the state agencies for the cost of administering the GSLP. The amount of administrative cost allowances in a year is equal to one percent of the total principal amount of the loans guaranteed. In 1986 Congress amended the Act, giving agencies such as the OSLC a "contractual right" to

receive both reimbursements and administrative cost allowances. 20 U.S.C. § 1078.

Third, the OSLC takes in money from non-federal sources. When a student defaults on repayment of a loan, the OSLC, pursuant to its guaranty, pays the lender and in return receives the note. Thirty percent of any money recovered flows to the OSLC, and seventy percent goes to the Secretary, who reimburses the OSLC for its payments to the lender. In addition, the OSLC charges guarantee premiums to lenders as a fee for guaranteeing student loans. The OSLC charges one percent of the principal amount as its fee. Finally, the OSLC receives interest and other investment income from its money held in a reserve fund.

Under the authority of the Act, the Secretary and the OSLC have entered into several "reinsurance agreements" whereby the OSLC has become the participatory state agency in the GSLP for the Ohio region. Under these agreements, the Secretary reinsures the OSLC's guarantees in exchange for the OSLC's administration of the GSLP. Specifically, the OSLC reviews loan applications, averts defaults where possible, reviews defaults, and of course, guarantees the loans. The Permanent Agreement states that "[t]he agency shall be bound by all changes in the Act or Regulations in accordance with their respective effective dates." J. App. at 33.

On December 22, 1987, as part of the Omnibus Budget Reconciliation Act of 1987, Congress amended the Act to limit the amount of cash reserves that a state guaranty agency could accumulate. Pub. L. No. 100-203, 101 Stat. 1330-36 (1987). In particular, 20 U.S.C. § 1072(e)(1) establishes a formula for determining the maximum amount of funds a guaranty agency may accumulate in its reserve fund. An agency with "excess" reserves (more than the statutory maximum) must transfer the excess to the Secretary. Under 20 U.S.C. § 1072(e)(2), the Secretary can enforce the transfer through one of the following methods: (1) making to the federal gov-

ernment from the state guaranty agency advance payments that are otherwise not due; (2) withholding and cancelling reimbursement claims that are otherwise payable; (3) reducing claims for administrative cost allowances; (4) paying an additional reinsurance fee to the Secretary; or (5) any other acceptable method of reducing payments from or increasing payments to the Secretary. The Secretary deposits all amounts collected under 20 U.S.C. § 1072(e)(2) into the GSLP student loan insurance fund established by 20 U.S.C. § 1081(a). The provisions of 20 U.S.C. § 1072(e) terminated on their own accord on September 30, 1989. The 1987 Amendments also modified 20 U.S.C. § 1078(c), by adding that the "contractual right" of the state agency to the reimbursement payments and the administrative cost allowances are "subject to section 1072(e) [the excess reserve provisions] of this title." In addition, 20 U.S.C. § 1072(e)(3) authorizes the Secretary to waive the requirements of 20 U.S.C. § 1072(e)(2) if there has been a change in the economic circumstance of the agency or the loan insurance program.

The Secretary determined that the OSLC had excess reserves of $26,075,259.00. On February 1, 1988, the OSLC informed the Secretary that it would not turn over the excess reserves to the Secretary because it believed that the requirements of the 1987 Amendments violated the contract between the Secretary and the OSLC. On February 9, 1988, the Secretary advised the OSLC of its obligation under the Act to transfer the excess reserves, and on March 15, 1988, the OSLC filed suit in the United States Distict Court for the Southern District of Ohio, Judge James L. Graham presiding, seeking declaratory relief. Because the OSLC did not elect a method for transferring the excess reserves, the Secretary began withholding reinsurance claims on September 8, 1988. In response, the OSLC added a request for injunctive relief to its complaint. The OSLC's complaint alleged that section 1072(e) was unconstitutional because it constituted a taking of private property without just compensation as

prohibited by the Fifth Amendment, a violation of the Due Process Clause, and a questioning of the public debt in violation of section four of the Fourteenth Amendment.

The district court ruled that the Secretary's withholding of the reinsurance funds breached the OSLC's contractual rights to the reimbursements. *Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (S.D. Ohio 1988). The court rejected the Secretary's characterization of the withholding of reimbursement payments as an additional reimbursement fee, noting that past reinsurance fees have been explicitly designated as such by Congress. *Id.* at 1418. The court concluded that the withholding of funds under section 1072(e) violates the Due Process Clause because abrogating a contract is not a "constitutionally permissible means" to the legitimate end of balancing the budget. *Id.* at 1419. The court also concluded that the Secretary's repudiation of the contract constitutes an unconstitutional questioning of the public debt under the Fourteenth Amendment because the Secretary is attempting to recover funds that it was obligated to pay to the OSLC.

In its denial of the motion for relief from judgment, the district court decided that the OSLC is a "person" entitled to the protection of the Due Process Clause. *Id.* at 1420-21. Additionally, the court noted that although it "did not address this theory [of taking of private property under the Fifth Amendment] in its original decision, it conclude[d] that this is also a legitimate ground for its decision." *Id.* at 1422. The court continued: "Valid contract rights are property which cannot be taken by the federal government without just compensation, even when the aggrieved party is a state governmental entity." *Id.* On May 22, 1989, the parties agreed to allow the Attorney General of the State of Michigan to file an *amicus curiae* brief on behalf of the OSLC.

II.

The first issue is whether the required transfer of "excess reserves" under section 1072(e)(1) constitutes a taking of property in violation of the Fifth Amendment.[1] Issues of law, decided pursuant to summary judgment, are freely reviewable by this court. *Loudermill v. Cleveland Board of Education,* 844 F.2d 304, 308 (6th Cir. 1988), *cert. denied,* 109 S.Ct 377 (1988). We examine first whether the excess reserves constitute "private property" and then whether there was any taking of that property.

A.

The OSLC contends that the approximately $26 million in excess reserves that it is required to transfer to the Secretary under section 1072(e) is "private property" under the takings clause. It relies upon *United States v. 50 Acres of Land,* 469 U.S. 24, 31 (1984), in which the Supreme Court stated that the "reference to 'private property' in the Takings Clause of the Fifth Amendment [encompasses] the property of state and local government when it is condemned."

The Secretary argues that the excess reserves are not the "private property" of the OSLC for three reasons. First, the OSLC is a federal agent, carrying out the federal wishes in its administration of the GSLP. Second, the Secretary argues that the OSLC does not have free use and enjoyment over the property, and as such, the OSLC is more the custodian than the owner of the funds. Third, the Secretary contends that the OSLC does not have any property rights to the excess

---

[1]At the end of its reply brief, the Secretary argues that the takings issue was not properly before the district court because the Tucker Act requires claims for more than $10,000 to go before the Court of Claims. Reply Brief of Appellants at 15. However, the Tucker Act is inapplicable because the OSLC is asking for declaratory and injunctive relief, not monetary damages.

reserves because it comes from sources other than the federal reimbursements.

In *Amen v. City of Dearborn*, 718 F.2d 789, 794 (6th Cir. 1983), *cert. denied*, 465 U.S. 1101 (1984), this court noted that "the definition of property is broad, encompassing the entire group of rights incidental to ownership." While there is a significant amount of federal regulation of the funds, the OSLC still has some of the rights of ownership. The OSLC performs services concerning the initial loans and the recovery of defaults. To this extent, it is incorrect to label the OSLC merely a "federal agent" for funds to flow through. However, there are significant federal limitations upon receipt and use of the funds.

In *Dayton-Goose Creek Railway v. United States*, 263 U.S. 456 (1924), Congress amended the Transportation Act, fixing rates to ensure that the railroad companies did not receive more than a "fair return" on their property. In rejecting a claim by the railroad that the Act was a taking of their property, the Court decided that the excess income was not the "private property" of the railroad because the railroad was simply a trustee of the funds under the Transportation Act. In the instant case, though the OSLC retains some control over the funds, its role is akin to that of a trustee. The OSLC does not "own" the funds under any reasonable definition of that term. It is the administrator of the funds which flow in and out of Ohio as part of the GSLP program. The OSLC is a public entity that is not interested in making any sort of profit in its administration of the program. Instead, it has chosen to join with the federal government to administer the GSLP program, knowing that the funds are ultimately to be disposed of according to the decisions of the federal government. While there may be constitutional limits to the federal government's transfer of funds from state programs, these limits are not reached in this case. Here, the Secretary is transferring the funds from a federal program with a state administrator, not a state program. Thus, because of the sig-

nificant federal regulation of the funds, we hold that the excess reserves do not constitute private property.

B.

Even if the excess reserves were "private property," in order to violate the Constitution, the private property must be "taken" by the government. In *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 224-25 (1986), an act modifying the terms under which an employer could withdraw from ERISA was challenged. In holding that the act did not constitute a taking of private property, the Supreme Court noted that even though the Act permanently deprived the employers of assets, "[i]n the course of regulating commercial ... affairs, Congress routinely creates burdens for some that directly benefit others," such as minimum wages and price controls. *Id.* at 223. In order to determine whether there was a taking, the Court established a three-prong test:

> (1) the economic impact of the regulation on the claimant;
> (2) the extent to which the regulation has interfered with distinct investment-backed expectations;
> (3) the character of the governmental action.

Id. at 225 (citations omitted).

Upon examination of these three factors, we find that the Secretary's action did not constitute a "taking" of the excess funds. First, the economic impact of the regulation is clearly to reduce the OSLC's reserves by approximately $26 million. However, the *Connolly* Court noted that the severity of the economic impact is the relevant factor; consequently, the Court took into account mitigating provisions in the statute. *Id.* Similarly, the instant case, section 1072(e)(3) allows the Secretary to waive recovery of the excess reserves upon showing of a financial hardship by the guaranty agency. The OSLC failed to file waiver because it could not show any hardship. Further, there has been no showing in the record that the

loss of the excess reserves would harm the operation of the OSLC—the excess funds were unnecessary *extra* insurance against future defaults.

The second factor, interference with the distinct investment-backed expectations, is also not met in the instant case. The *Connolly* Court noted that expectations are not great when employers "had more than sufficient notice not only that their plans were currently regulated, but also that withdrawal itself might trigger additional financial obligations." *Id.* at 227. Similarly, the OSLC was significantly regulated and on notice in the agreements that there might be future regulations or amendments. Futhermore, the OSLC is a non-profit, state governmental agency with no reasonable expectation of keeping its excess reserves. The funds come from the GSLP program, which is operated in conjunction with the federal government.

The third factor, the character of the governmental action, is also not met. The *Connolly* Court noted that under the statute in that case, the government did not permanently appropriate the employer's assets for its own use, but regulated the participants in the pension plans for the common good. *Id.* at 225. In the instant case, the OSLC argues that the federal government is taking the funds for its own use—to reduce the budget deficit. However, another reason for the transfer exists—to redistribute the funds. The excess funds go to a GSLP loan insurance fund established by 20 U.S.C. § 1081(a). Upon transfer from the guaranty agencies to the GSLP loan insurance fund, the funds could be used more immediately in states with agencies that do not have excess reserves. Accordingly, we conclude that the transfer of funds under section 1072(e) does not take private property without just compensation in violation of the Fifth Amendment.

III.

The OSLC also argues that the enforcement provisions of the amendments are unconstitutional because they breach the

OSLC's contractual rights to reinsurance payments. The OSLC posits that the abrogation of their contractual rights violates three provisions of the Constitution: the Takings Clause, the Due Process Clause, and section four of the Fourteenth Amendment.

A.

The district court noted that the contract rights found in 20 U.S.C. § 1078(c) (an agency has "a contractual right against the United States" to reimbursement) are property under *Lynch v. United States*, 292 U.S. 571 (1934). The Secretary responds that there was no abrogation of any "contract" for three reasons. First, the Secretary argues that the OSLC has no contractual right to the excess funds. Since OSLC could have chosen another method of transfer of the funds, the Secretary maintains that OSLC's *voluntary* choice of this method cannot be seen as an abrogation of the agreement. Second, the Secretary argues that withholding the funds was in accordance with the agreements. Third, the Secretary argues that section 1072(e) did not abrogate any contract created by section 1078 because the Act allowed for future amendments and changes.

We believe that section 1072(e) does not breach any "contract." In *Lynch*, Congress passed a statute that abrogated all outstanding insurance contracts in which the federal government had provided War Risk Insurance. In holding that the statute violated the takings clause, the court noted that "[v]alid contracts are property, whether the obligor be a private individual, a municipality, a State, or the United States." *Id.* at 579. We think that the "contract" in the instant case, unlike that in *Lynch*, does not constitute *property* under the takings clause. Notably, the statute in *Lynch* totally repealed the War Risk Insurance Act, while the 1987 Amendments merely altered the terms of the agreements. In addition, the insurance agreements in *Lynch* were between the federal government and individuals, whereas in the instant

case, the agreements are between the Secretary and the OSLC concerning an appropriate way to share governmental authority in the administration of the GSLP. When viewed as a codification of the cooperative relationship between the federal and state agencies, the "contract" between the Secretary and the OSLC does not generate property rights under the takings clause. Even though section 1078 gives the agencies "contractual rights," they do not rise to the level of *property* under the Fifth Amendment. Instead, as with a number of other programs that involve the cooperation of the federal and state governments, the federal government has the power to change the terms of the relationship without taking the "property" of the state in violation of the Fifth Amendment.

Not only are the agreements not "property" under the Takings Clause, but also there was no abrogation of the contract for two reasons. First, the Agreements allow the Secretary to withhold the reinsurance funds. Specifically, the Agreements provide that if the Secretary finds a failure of the OSLC to abide by federal law or regulations, he may take such action as is necessary to protect the interests of the United States, including "withholding payments to be made to [OSLC]." J. App. at 23, 28. Even if the OSLC has contractual rights under section 1078, the Secretary's actions do not violate the contract since such action is specifically provided for.

Second, and more importantly, the agreement did not foreclose the possibility of future Congressional acts, and as such, the 1987 Amendments were consistent with the agreement. In *Bowen v. Public Agencies Against Social Security Entrapment,* 477 U.S. 41 (1986), the State of California challenged an amendment to the Social Security laws. Previously, if a state obtained Social Security coverage for its employees, the law permitted that state to terminate the agreement providing coverage with two years notice. The amendments prevented the states from terminating these agreements. The State of California maintained that the old law created a "contractual

right" that constituted private property under the Takings Clause of the Fifth Amendment. The Supreme Court ruled that the amendments to the act did not violate the Takings Clause because "Congress reserved the authority to amend" the statute and the agreements. *Id.* at 53. The Court noted that unlike *Lynch*, the *Bowen* case involved a provision of an act that "was part of a regulatory program over which Congress retained authority to amend in the exercise of its power to provide for the general welfare." *Id.* at 55.

The OSLC attempts to distinguish *Bowen* by arguing that in *Bowen*, Congress explicitly preserved the right to amend the act, while in the instant case, Congress "surrendered" the right to alter the "contract" through section 1078's language giving contractual rights to the OSLC. This distinction is inconsequential. While admittedly Congress did not expressly reserve the right to amend the statute in the future, it did not have to do so in order to preserve the power. The *Bowen* Court warned that "courts should be extremely reluctant to construe [the statute] in a manner that forecloses Congress' exercise of authority." *Id.* at 52. It noted that:

> [W]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms. Therefore, contractual arrangements, including those to which a sovereign itself is a party, 'remain subject to subsequent legislation' by the sovereign.

Id. (citations omitted). Upon review of the record, we conclude that Congress did not use unmistakable language to surrender its authority to amend. It simply gave a contractual right to the OSLC. Even without any reference in the Act to future amendments, Congress retained the sovereign authority to amend and alter the regulatory scheme without unconstitutionally taking property.

In addition, under the reinsurance agreements, the OSLC agreed to be "bound by all changes in the Act or Regulations." J. App. at 21, 28. These agreements give notice to the OSLC of possible legislative changes. Under the OSLC's construction of the agreements as a normal contract, this is contractual language reserving to Congress the power to change that contract. That Congress did not expressly reserve the power in the Act is irrelevant under the OSLC's construction. Thus, we hold that the Secretary did not *abrogate* any "contractual rights," but merely *altered* the contract.

B.

The district court also ruled that the withholding of the reinsurance funds violates the Due Process Clause of the Fifth Amendment. The court first decided that the Secretary's characterization of the withholding as a prospective reinsurance fee would violate the equal protection component of the Due Process Clause. 709 F. Supp. at 1418. However, on appeal the Secretary has renounced this characterization. Still remaining is the district court's determination that the "repudiation by the federal government of a valid contract [as accomplished in section 1072] is a violation of the Due Process Clause of the Fifth Amendment unless necessary for the exercise of the federal police power or other overriding federal interests." *Id.* at 1420.

Because we earlier concluded that the Secretary did not repudiate the "contract" with the OSLC, the enforcement of the transfer clearly has a rational relationship to the legitimate goals of reducing the deficit and redistributing the funds. Thus, we hold that section 1072 does not violate the Due Process Clause.

C.

The district court also concluded that the defendant's repudiation of their contractual obligations constituted a questioning of the public debt, thus violating section four of the

Fourteenth Amendment. The court relied upon *Perry v. United States*, 294 U.S. 330, 351 (1935), in which the Supreme Court ruled that the United States could not repudiate its contractual obligation to purchasers of bonds to redeem their bonds in gold. The *Perry* Court concluded that the government could not abrogate its contracts in an attempt to "lessen government expenditures," because it would question the public debt. *Id.* at 352-53. Again, because we find no abrogation of the "contract" in the instant case, we conclude that there was no violation of section four of the Fourteenth Amendment.

IV.

Accordingly, the decision of the district court is **REVERSED**, and **REMANDED** with instructions to remove the preliminary injunction and to dismiss the complaint.

GUY, Circuit Judge, concurring. I agree with the result reached by the majority, but I would proceed from a single, precise conceptualization of the "property" at issue in analyzing the constitutional and contractual claims raised in this case. The court appears to view this dispute as a direct contest for the Ohio Student Loan Commission (OSLC) reserve fund. While I concede that the reserve fund balance plays an important role in this dispute, it seems to me that the reinsurance payments withheld by the Secretary, rather than the OSLC's cash reserves, constitute the "property" underlying this contest. The OSLC has not argued, nor could it argue, that the Secretary has raided its reserve fund. The language chosen by Congress constrains the Secretary's encroachment by instructing the Secretary merely to "direct the agency to eliminate such excess by any one or more of the [specified] methods, as selected by the guarantee agency[.]" 20 U.S.C.A. § 1072(e)(2) (Supp. 1989). Only after the OSLC refused to comply with such a directive did the Secretary refuse to provide the OSLC with reimbursement payments. In this action subsequently filed to obtain reinstatement of the payments on constitutional and contractual grounds, the OSLC could only contend that, because the Higher Education Act as amended contains a "clear indication that the legislature intend[ed] to bind itself contractually" to reinsure guarantee agencies, *see National R. R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry.*, 470 U.S 451, 465-66 (1985), state guarantee agencies have a property right in reimbursement for payments made to satisfy guarantees on loans in default. Although the OSLC might prefer to debate the Secretary's authority (or lack thereof) to raid the agency's reserve fund, this case turns exclusively on the Secretary's authority (or lack thereof) to withhold reimbursement payments. Thus, I would focus solely upon the propriety of the Secretary's refusal to reimburse the OSLC for guarantee payments made by the state agency.

As of 1986, Congress had statutorily pronounced that guarantee agencies such as the OSLC possessed "a contractual

right against the United States" to reimbursement for guarantee payments and to administrative cost allowances. On December 22, 1987, however, a statutory qualification was engrafted upon these two previously unqualified rights. Specifically, both rights were made "subject to" the contemporaneously enacted provision concerning the reduction of excess cash reserves. *See* Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, Title III, § 3001(b), 101 Stat. 1330-38 (conforming amendments to 20 U.S.C. §§ 1078(c)(1)(A) & 1078(f)(1)(B)). Under these conditions added by Congress, the OSLC's continued receipt of reinsurance payments depended upon the OSLC's compliance with the Secretary's directives regarding reduction of the guarantee agency's reserve fund. *See* 20 U.S.C.A. § 1078(c)(1)(A) (Supp. 1989). Even assuming that the OSLC possessed a property interest in reinsurance payments, *cf. Lynch v. United States*, 292 U.S. 571, 579 (1934) ("Valid contracts are property, whether the obligor be a private individual, a municipality, a State, or the United States."), I do not believe that either Congress or the Secretary has disavowed or abrogated any obligation to furnish the OSLC with reinsurance. The imposition of additional conditions "[e]ven with respect to vested property rights" is well within the power of Congress. *See, e.g., United States v. Locke*, 471 U.S. 84, 104 (1985). Here the Secretary has simply conditioned payment of reinsurance to the OSLC upon compliance with new conditions concerning reduction of the OSLC's reserve fund. This action neither works an impermissible taking of property nor constitutes a breach of contractual obligations.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OHIO

CASE NUMBER: C-2-88-0314

Ohio Student Loan Commission

V.

Lauro F. Cavazos, Secretary of the United States Department of Education, et al.

FILED

DEC 19 1988

KENNETH J. MURPHY, Clerk
COLUMBUS, OHIO

JUDGMENT IN A CIVIL CASE

☒ **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the provisions of 20 U.S.C. §1078(e) are in violation of the Fifth and Fourteenth Amendments to the United States Constitution to the extent that they operate to withhold funds from the plaintiff Ohio Student Loan Commission on reinsurance of loans originated before December 22, 1987. The defendants Lauro F. Cavazos, Secretary of the United States Department of Education, and the United States Department of Education are hereby enjoined from further withholding such reinsurance payments to the Ohio Student Loan Commission or any other attempt at implementing the cash recovery provisions of 20 U.S.C. §1078(e) as they relate to the Ohio Student Loan Commission. The

defendants are ordered to repay the Ohio Student Loan Commission the funds which they have wrongfully withhold. **JUDGMENT** is hereby entered in favor of the plaintiff Ohio Student Loan Commission on its complaint, and the plaintiff's costs are assessed to the defendant.

December 19, 1988
Date

KENNETH J. MURPHY
Clerk

/s/ Beverly Robinson
(By) Deputy Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

Case No. C-2-88-314
JUDGE GRAHAM

Ohio Student Loan Commission,

Plaintiff,

vs.

Lauro F. Cavazos, Secretary of the United States Department of Education, et al.,

Defendants.

FILED
KENNETH J. MURPHY
CLERK

DEC 19 3:25 PM '88

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

OPINION AND ORDER

Plaintiff Ohio Student Loan Commission ("OSLC") filed this action against defendants William J. Bennett, Secretary of the United States Department of Education ("Secretary") and the United States Department of Education ("Department"), seeking declaratory relief. Lauro F. Cavazos, successor in office to William J. Bennett, has been substituted as a party defendant, in his capacity as Secretary of the United States Department of Education.

In its complaint, the OSLC asserts six claims. The OSLC contends that the defendants' recovery of excess cash reserves from the OSLC's reserve fund pursuant to 20 U.S.C.

§1072(e) (Supp. 1988) (effective Dec. 22, 1987) constitutes (1) a taking of contractual rights without just compensation in violation of the Fifth Amendment to the United States Constitution, (2) a taking of non-federal monies without just compensation in violation of the Fifth Amendment, (3) a questioning of the validity of the public debt of the United States in violation of the Fourteenth Amendment, (4) an unreasonable and arbitrary action in violation of the Fifth Amendment, (5) an arbitrary classification of state guaranty agencies to which the recovery provisions are applicable in violation of the Fifth Amendment, and (6) a breach of the contracts between the parties.

PROCEDURAL BACKGROUND

The OSLC filed its complaint on March 15, 1988. On May 13, 1988, the defendants filed a motion to dismiss on the grounds that the OSLC had failed to exhaust available remedies pursuant to the waive provisions of 20 U.S.C. §1072(e)(3)(A). This motion was rendered moot by a joint stipulation filed by the parties on June 23, 1988. On May 13, 1988, the defendants also filed a motion to transfer the case to the United States District court for the District of Columbia. On August 12, 1988, the Hon. Mark R. Abel, United States Magistrate, issued an order denying the motion to transfer.

On September 9, 1988, the OSLC filed an application for a temporary restraining order and preliminary injunction seeking to enjoin the defendants from implementing the cash recovery provisions of 20 U.S.C. §1072(e). On the same day, the Court held a preliminary informal conference on the application pursuant to S. D. Ohio R. 3.7.1 and, at the conclusion thereof, orally denied the application for temporary restraining order and set a preliminary injunction hearing for Wednesday, October 12, 1988. A written order was filed on September 13, 1988 incorporating these rulings. The hearing on the application for preliminary injunction was subsequently consolidated with trial

on the merits pursuant to Fed. R. Civ. P. 65(a)(2) and the hearing date re-scheduled for Monday, November 7, 1988. Pursuant to the final pretrial order, the OSLC withdrew its application for preliminary injunction. The trial on the merits took place on Monday, November 7, 1988. Mr. David Harmon, who was employed by the OSLC for thirteen years until June of 1988, the last three years as executive director, and Dr. James Biddle, executive director of the OSLC since June 13, 1988, testified on behalf of the plaintiff. The defendants did not call any witnesses. The matter is now ripe for decision.

STATEMENT OF FACTS

The Ohio Higher Education Assistance Commission ("OHEAC") was created by the Ohio General Assembly in 1961 and began operations in 1962. The OHEAC was originally funded solely with state appropriations and was designed to administer state programs to assist Ohio residents attending institutions of post-secondary education. In particular, the OHEAC guaranteed loans made by private lenders to certain eligible students.

Three years later, the United States Congress created the Guaranteed Student Loan Program pursuant to the Higher Education Act of 1965, as amended, 20 U.S.C. §1071 *et seq.* The purpose of this program was to encourage states and nonprofit organizations and institutions to establish student loan guaranty programs, to provide a federal guaranty program for those students not having reasonable access to state or private guaranty programs, to subsidize interest payments on student loans, and to reinsure state and private guaranty programs. 20 U.S.C. §1071(a). In response to this federal program, the Ohio General Assembly created the OSLC, pursuant to Chapter 3351 of the Ohio Revised Code, as a successor to the OHEAC. The creation of such a commission was authorized by Article VI, Section 5 of the Constitution of the State of Ohio.

The OSLC is a state agency created for the administration of Ohio's student loan guaranty program. The OSLC is authorized to enter into contracts and to sue and be sued in its own name. O.R.C. §3351.07. In addition, O.R.C. §3351.07(A)(2) expressly states "that no obligation of the commission shall be a debt of the state, and the commission shall have no power to make its debts payable out of moneys except those of the commission." The OSLC is also expressly authorized to accept federal funds and to enter into contracts pursuant to the Higher Education Act of 1965, as amended, 20 U.S.C. §1071 *et seq.* O.R.C. §3351.13.

The OSLC was originally funded by state appropriations, guarantee premiums charged to lenders and passed on to student borrowers, interest and other investment income, and the assets of the OHEAC which were transferred to the OSLC. The sources of funds now held by the OSLC are the original state appropriations the guarantee premiums, federal administrative cost allowances received from the federal government, federal reinsurance payments received from the federal government, service fees from lenders and schools, thirty percent of the total amount collected on defaulted loans, and interest and investment income. *See* Defendants' Exhibit "D" at 11. Although the OSLC retained certain federal advances in its reserve fund as of September 30, 1986, there is some question as to whether these advances have been repaid.

The state appropriations predate 1967 and total approximately $976,000. The guarantee premiums are charged by the OSLC to lenders as a fee for guaranteeing student loans. State guaranty agencies such as the OSLC are authorized by 20 U.S.C. §1078(b)(1)(H) to collect a guarantee premium on each loan not to exceed three percent of the principal amount. This premium can be passed on by the lender to the student borrower. The OSLC charges one percent of the principal amount.

The OSLC also receives administrative cost allowances from the federal government pursuant to 20 U.S.C. §1078(f). This provision authorizes the Secretary of Education to pay administrative cost allowances to state guaranty agencies in order to compensate them for the costs of administering the Guaranteed Student Loan Program. The total amount of administrative cost allowances to be paid to a state guaranty agency during any fiscal year is to be equal to one percent of the total principal amount of the loans guaranteed by the agency during that fiscal year. 20 U.S.c. §1078(f)(1)(B). Prior to December 22, 1987, this statutory provision stated that "[t]he guaranty agency shall be deemed to have a *contractual right* against the United States to receive payments" of administrative cost allowances. (Emphasis added).

Another form of federal funding received by the OSLC is federal reinsurance payments pursuant to 20 U.S.c. §1078(c). The Secretary of Education is authorized to enter into guaranty agreements with state guaranty agencies whereby the Secretary agrees to reimburse the agencies for losses they sustain due to defaults by student borrowers. 20 U.S.C. §1078(c)(1)(A). When a student defaults, the lender files a claim with the OSLC for reimbursement of the balance remaining on the loan obligation. The OSLC pays the lender out of its reserve fund and then files a claim with the Department of Education for reinsurance. According to 20 U.S.C. §1078(c)(1)(B), if a state guaranty agency's default rate is five percent or less of the total amount of loans insured by the agency, the Department of Education will reimburse the agency on one hundred percent of the defaults. However, if the default rate is between five and nine percent, then the Department will only reimburse the agency on ninety percent of the defaults and if the default rate exceeds nine percent, the Department will reimburse the agency on only eighty percent of the defaults. One hundred percent reinsurance first became available in 1976, and the OSLC has qualified for

that level of reinsurance from that time to the present. The parties agree that the OSLC has incurred more administrative costs and has paid more funds for defaulted student loans since 1965 than the federal government has reimbursed the OSLC with administrative costs allowances and reinsurance payments. Stipulation of Facts at Paragraphs 4, 5.

The OSLC also receives fees for services rendered to lenders and schools. If the lender so elects, the OSLC will service the loans issued by the lender and guaranteed by the OSLC. In addition, the OSLC disseminates information concerning the Guaranteed Student Loan Program and trains employees of lenders and schools. Any fees collected for these and other miscellaneous services are deposited in the reserve fund.

Another source of funds for the OSLC is derived from collections on defaulted loans. If a state guaranty agency collects on a defaulted student loan or which it has already reimbursed the lender and for which it has received reinsurance from the Department of Education, the agency may retain thirty percent of the collected payments for costs incurred in administering the program, in particular its default collection and prevention efforts. 20 U.S.C. §1078(c)(6). Finally, the interest and other investment income generated by all these funds are retained in the OSLC's reserve fund. All of these funds are held in an unsegregated reserve fund.

Pursuant to the authorization of O.R.C. §3351.13, the OSLC has in fact entered into contracts with the United States Department of Education whereby the OSLC has become a participatory state guaranty agency in the Guaranteed Student Loan Program. The contracts entered into by the parties are the 80% Agreement: Agreement for Federal Reinsurance of Loans Pursuant to 428(c) of the Higher Education Act of 1965, as amended; the 100% Agreement: Supplemental Guaranty Agreement for Fed-

eral Re-insurance of Loans, Higher Education Act of 1965, as amended; and the Permanent Agreement. In exchange for the OSLC's administration of and compliance with the statutory and regulatory requirements of the Guarantee Student Loan Program, the federal government agreed to reinsure the OSLC pursuant to the Agreement for Federal Reinsurance and the Supplemental Guaranty Agreement. According to the Agreement for Federal Reinsurance, the OSLC is entitled to 80% reinsurance on funds it spends to cover defaulted loans. According to the Supplemental Guaranty Agreement, the OSLC is entitled to 100% reinsurance, provided that the default rate on its guaranteed loans does not exceed five percent. The Permanent Agreement obligates the federal government to subsidize the interest rates charged by the private lenders.

The Guaranteed Student Loan Program involves five parties. The participants are the lender, the student borrower, the educational institution of higher learning, the state guaranty agency, and the United States Department of Education. The student borrower who desires a guaranteed student loan first applies to a private lender and provides the educational institution with basic eligibility information. The typical repayment term of a guaranteed student loan is ten years, although some loans have a repayment term of up to twenty-five years. The state guaranty agency guarantees the loan by agreeing to reimburse the lender in whole or in part for any loans upon which the student borrower defaults. The state guaranty agency also collects guarantee premiums from the lender which are passed on to the student borrowers. The Department approves the participation of schools, lenders, and guaranty agencies, and administers the program generally. The Department reimburses the state guaranty agencies for outlays they make to lenders to cover defaulted student loans and the Department reimburses the state guaranty agencies for certain administrative costs incurred in administering the program. The Department also makes di-

rect payments to lenders in order to subsidize the interest payments while the students are in school and during a six-month grace period thereafter and to supplement the loan's interest rate. United States General Accounting Office, Guaranteed Student Loans: Better Criteria Needed for Financing Guarantee Agencies, 9-11 (1986).

The arrangement which is presently in effect between the OSLC and the Department of Education was formalized by contractual agreements during 1977 pursuant to the Higher Education Act of 1965, as amended, 20 U.S.C. § 1071 et seq. Pursuant to the 100% Agreement: Supplemental Guaranty Agreement for Federal Re-insurance of Loans, Higher Education Act of 1965, as amended, Clause 2, the parties agreed as follows:

> The commissioner [now secretary of the Department of Education] shall reimburse the Agency, at such times, in such manner, and on the basis of such documentation as he may from time to time reasonably prescribe, with respect to losses (resulting from the default of student borrowers . . .) on the unpaid balance of the principal and accrued interest of any student loan issued under the Agency's Student Loan Insurance Program in an amount equal to one hundred per centum (100%) of the amount expended by the Agency in the discharge of its insurance obligations incurred under its Student Loan Insurance Program. (Emphasis added).

As discussed supra, the Secretary awas authorized to enter into this agreement and create contractual rights in the OSLC pursuant to 20 U.S.C. § 1078(c)(1)(A).

The OSLC has entered into agreements with the federal government to act as its agent in administering the Guaranteed Student Loan Program. The OSLC entered into these agreements in its own name. The primary functions of the OSLC as a participatory state agency in the Guar-

anteed Student Loan Program are to guarantee student loans, to review loan applications, to avert defaults, and to review defaults. In order to participate in the Guaranteed Student Loan Program, the OSLC must comply with all of the requirements set forth in the Higher Education Act of 1965, as amended, 20 U.S.C. §1071 *et seq.* and the regulations promulgated thereunder. In addition, the OSLC also performs functions over and above what the federal law requires of state guaranty agencies. In particular, the OSLC provides information to families concerning the program and trains employees of schools and lenders regarding their participation in the program. These additional efforts have been a significant factor in the OSLC's low default rate.

On December 22, 1977, Congress enacted the Omnibus Budget Reconciliation Act of 1987. Portions of the Omnibus Budget Reconciliation Act of 1987 amended the Higher Education Act of 1985 to limit the amount of cash reserves that a state guaranty agency could accumulate. In particular, 20 U.S.C. §1072(e)(1) was enacted to limit cash reserves to the greater of:

> (A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;
>
> (B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;
>
> (c) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;
>
> (D) $500,000; or
>
> (E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

The Secretary was required to determine by March 31, 1988 the excess cash reserves each state guaranty agency had for fiscal year 1986. 20 U.S.C. §1072(e)(2). The total reduction of excess cash reserves for all state agencies was limited to $250,000,000 in fiscal year 1988. 20 U.S.C. §1072(e)(4). Once the Secretary determined that an agency had excess cash reserves, he was to direct the agency to reduce the reserves:

> (A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d) of this section;
>
> (B) by withholding and cancelling claims for reimbursement otherwise payable under section 1078(c)(1) of this title;
>
> (C) by reducing the amount of payments for which application will be made by such agency under section 1078(f) of this title; or
>
> (D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 1078(c)(9) of this title, as proposed by the agency and agreed to by the Secretary.

20 U.S.C. §1072(e)(2). The excess cash reserves recovered were to be deposited into the Department's student loan insurance fund established for satisfaction of the Department's guarantee obligations. 20 U.S.C. §1081(a). The Court notes that the cash recovery provisions of 20 U.S.C. §1072(e) were prospectively repealed effective September 30, 1989 by the same legislation that enacted them.

After the excess cash recovery provisions had been enacted but before being contacted by the Department of Education, David Harmon sent a letter dated February 1, 1988 to the Secretary of the Department of Education.

Therein, Harmon expressed the position of the OSLC in regard to the newly enacted 20 U.S.C. §1072(e) stating that it considered the contracts between the parties to be valid and binding and any attempt to recover excess cash reserves from the OSLC would be a repudiation of the contracts between the parties. David Harmon subsequently received a letter from the Department dated February 9, 1988, advising the OSLC of the cash recovery provisions and informing the OSLC that it was determined to have $26,075,259 in excess cash reserves. This figure was reached by utilizing 20 U.S.C. §1072(e)(2)(E), the minimum amount required by state law to be kept in the reserve fund. The letter also stated that the OSLC must choose a means of payment by February 29, 1988 or else a method of payment would be chosen for it. The deadline was later extended to March 15, 1988.

The OSLC failed to elect a method for reducing excess cash reserves but the Department did not seek to implement the cash recovery provisions against the OSLC until September 8, 1988. The OSLC rejected the September 8, 1988 implementation by the defendants on the grounds that it breached the contracts between the parties and did not accurately determine the adequacy of the OSLC's reserve fund. The defendants have refused to pay reinsurance claims which the OSLC has submitted from April, 1988 until the present. This withholding of funds has been without distinction as to whether the reinsurance relates to loans made before or after December 22, 1987, the effective date of the excess cash recovery provisions.

The defendants now allege that the excess cash recovery provisions are in the nature of an additional reinsurance fee, rather than the recovery of federal monies already paid to the OSLC. In response to this allegation, the OSLC contends that this representation had never been made to them before. Mr. Harmon testified that in all of his dealings with the defendants he never heard that 20 U.S.C. §1072(e) was a fee for the defendants providing reinsur-

ance. In addition, the defendants have not brought to the Court's attention any mention of a reinsurance fee in the legislative history or General Accounting Office reports regarding the excess cash recovery provisions. Dr. Biddle also testified that the defendants never in the past represented that the cash recovery provisions were a reinsurance fee. Neither have the defendants mentioned any changes in the contracts between the parties or in the methods of compensation.

LEGAL ANALYSIS

The Court must consider whether there was a valid binding contract between the parties regarding reinsurance payments, whether the excess cash recovery provisions of 20 U.S.C. §1072(e) breached that contract, and whether that breach was unlawful or violative of the Constitution of the United States. As discussed, *supra*, the parties entered into agreements during 1977 by which the OSLC agreed to administer the federal Guaranteed Student Loan Program and to comply with all the statutory and regulatory requirements thereof. In turn, the defendants agreed to reinsure the OSLC on 100% of the losses it incurred due to its guarantee obligations on defaulted student loans.

These agreements were authorized by 20 U.S.C. §1078(c). Although rights conferred by statute are generally not contractual in nature, Congress can create contractual rights binding on itself if it clearly indicates that intention. *National R.R. Pass. Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 466 (1985); *Dodge v. Board of Education*, 302 U.S. 74, 78 (1937). In the instant case, Congress clearly intended to create contractual rights between the federal government and the OSLC. Prior to December 22, 1987, 20 U.S.C. §1078(c)(1)(A) provided that "[t]he guaranty agency shall be deemed to have a *contractual right* against the United States, *during the life of such loan*, to receive reimbursement according to the provisions of this subsection." (Emphasis added). On De-

cember 22, 1987, this provision was amended so that "[t]he guaranty agency shall, *subject to section 1072(e) of this title*, be deemed to have a contractual right against the United States. . . ." (Emphasis added). Effective September 30, 1989, however, the amendment shall be repealed and this additional language stricken. Section 3002 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 1987 U.S. Code Cong. & Admin. News (101 Stat.) 1330-38.

The reinsurance agreements between the parties were in effect before December 22, 1987, and the OSLC, in reliance upon those agreements and 20 U.S.C. §1078(c)(1)(A), entered into contracts with eligible private lenders. In exchange for the participation in the Guaranteed Student Loan Program, the OSLC obligated itself to reimburse the lenders on 100% of all defaulted loans. A major portion of the loans for which the OSLC presently has contractual guarantee obligations with lenders was originated prior to December 22, 1987. The Court concludes that the OSLC had a vested contractual right to reinsurance payments from the federal government on all of its guaranteed student loans originated prior to December 22, 1987.

It would appear that the defendants have breached the reinsurance contract by withholding reinsurance payments on claims made by the OSLC on defaults covered on loans originated prior to December 22, 1987. The defendants have withheld all payments on these claims since April, 1988, and have expressed their intention to continue the withholding until they have withheld $26,075,259 in what they consider excess cash reserves.

The Department of Education, however, contends that it has not breached the contracts between the parties, but has only charged the OSLC an additional fee for providing reinsurance. According to this argument, the withholding of reimbursement payments from the OSLC is not a breach

of contract but merely a means by which the OSLC may pay the additional reinsurance fee.

This argument is without merit. Although Congress had in the past assessed a reinsurance fee from state guarantee agencies, see 20 U.S.C. §1078(c)(9), the instant assessment is of a totally different nature. The prior fee was expressly entitled a "reinsurance fee" and operated as such. The plain meaning of the statutory language clearly does not support a reinsurance fee characterization. If Congress had intended 20 U.S.C. §1072(e) as simply an additional reinsurance fee, then it would appear to have been inconsistent in amending the reinsurance provisions of 20 U.S.C. §1078(c)(1)(A) to be subject to the provisions of 20 U.S.C. §1072(e). In addition, the amount of the §1078(c)(9) reinsurance fee is related directly to the volume of loans being guaranteed by the state guaranty agency. The excess cash recovery provisions are not tied to the number or amount of loans being guaranteed; instead, they only relate to the amount of money in the fund. If Congress intended to create an additional reinsurance fee, the expected method of implementing such a fee would be to amend 20 U.S.C. §1078(c)(9). Yet it is interesting to note that Congress amended 20 U.S.C. §1078(c)(9) to be subject to the provisions of 20 U.S.C. §1072(e). The silence of the legislative history and General Accounting Office reports also mitigate against a finding of a reinsurance fee. The Court concludes that the statutory provisions are clear and unambiguous and that 20 U.S.C. §1072(e) was not intended as an additional reinsurance fee; it was instead, as discussed *infra*, an attempt to appropriate the funds of a state agency as a part of Congress's efforts to reduce the budget deficit.

Even if the Court were persuaded to adopt the defendants' characterization of 20 U.S.C. §1072(e) as an additional reinsurance fee, this would run afoul of the "equal protection" aspects of the Due Process Clause of the Fifth Amendment. Although the Fifth Amendment does

not contain an Equal Protection Clause, "it does forbid discrimination that is 'so unjustifiable as to be violative of due process.' " *Schneider v. Rusk*, 377 U.S. 163, 168 (1964), *quoting Bolling v. Sharpe*, 347 U.S. 497, 499 (1954). In the absence of a fundamental interest, the test for determining whether a classification created by Congress violates the Due Process Clause is whether the classification is rationally related to a legitimate government interest.

In the instant case, 20 U.S.C. §1072(e) is *de facto* applicable only to those state guaranty agencies which have accumulated excess cash reserves. The ability of an agency to generate excess cash reserves is a result of its efficient operation, ability and efforts to avert defaults on student loans, and wise investment of its resources. As demonstrated by the variable reinsurance levels of 20 U.S.C. §1078(c)(1), Congress desires to discourage defaults on student loans. However, the excess cash recovery provisions are only applicable to agencies which have accumulated excess cash reserves, and thus, have presumably been successful in maintaining low default levels. Agencies which have been operated inefficiently and have high default rates are not required to pay anything to the federal government pursuant to the excess cash recovery provisions.

An anticipated purpose for an additional reinsurance fee would be to encourage inefficiently operated state guaranty agencies to improve their performance. At the least, it would be expected that an additional fee would be a fee assessed to all state agencies for the service provided by the federal government in reinsuring the guaranteed loans. The instant excess cash recovery provisions further neither legitimate governmental interest.

The underlying purpose for the excess cash recovery provisions was to reduce the federal budget deficit. This is obvious from the fact that these provisions were enacted as part of the Omnibus Budget Reconciliation Act of 1987, which was designed to further the ends embodied by the

Gramm-Rudman-Hollings Act. In addition, the Congress placed a $250,000,000 ceiling on the amount of excess cash reserves that could be recovered during fiscal year 1988 and limited the duration of recovery to the period from December 22, 1987 to September 30, 1989.

Although Congress certainly has a legitimate governmental interest in reducing the federal budget deficit, indeed it is a highly laudable goal, the taking of the valid contractual rights of others is not a constitutionally permissible means to that end. Neither does the imposition of an irrational reinsurance fee bear a rational relationship to the reduction of the federal budget deficit. The defendants have not presented nor has this Court discovered any legitimate governmental interest rationally furthered by the excess cash recovery provisions. Therefore, even if 20 U.S.C. §1072(e) were characterized as an additional reinsurance fee, it would violate the Due Process Clause of the Fifth Amendment.

The defendants also contend that the version of 20 U.S.C. §1078(c)(1)(A) which was in effect prior to December 22, 1987 implicitly authorized Congress to change its provisions in any way, at any time. The statute granted "a contractual right against the United States, during the life of such loan, to receive reimbursement *according to the provisions of this subsection.*" (Emphasis added). The defendants argue that the latter clause allows Congress to modify the provisions of the subsection, and therefore, qualify in an unlimited manner the right to reimbursement. In particular, the defendants point out that Congress did amend the provisions of the subsection by making it "subject to section 1072(e) of this title."

This position is patently without merit. Certainly the phrase "according to the provisions of this subsection" referred to those provisions in effect at that time. The other provisions provided for the level of reimbursement, the distribution of amounts subsequently collected on de-

faulted loans, reinsurance fees, etc. Congress would not be able to retroactively amend these other provisions any more so than the provision creating contractual rights.

In addition, the defendants contend that they have not breached the reinsurance contract between the parties because they did not compel the OSLC to reduce its excess cash reserves by having its reinsurance claim withheld. They contend that the OSLC could have reduced its excess cash reserves by any other method provided by 20 U.S.C. §1072(e)(2). This argument is also without merit. This is merely a circuitous means to collect funds from the OSLC. The Court must look to function over form. The other methods for reducing excess cash reserves represent other *de facto* payments by the OSLC which it is not obligated to pay contractually or statutorily, apart from the provisions of the excess cash recovery provisions. In effect, these other methods would be coerced payments which would function to satisfy the requirements of the excess cash recovery provisions. The result is the same: retroactive reduction of the funding which the federal government contractually agreed to provide for the OSLC in exchange for its administration of the Guaranteed Student Loan Program.

Finally, the defendants allege that Congress can unilaterally change the terms of contractual agreements into which the federal government has entered. In support of this proposition, the defendants cite *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477i U.S. 41 (1986) and the *Sinking-Fund Cases*, 99 U.S. (9 Otto) 700 (1879). Both cases are inapposite to the instant case. In the *Sinking-Fund Cases*, the Supreme Court expressly recognized that "[t]he United States are as much bound by their contracts as are individuals." 99 U.S. (9 Otto) at 719. However, Congress can in certain circumstances, impose conditions on future obligations under valid contracts. *Id.* at 721. In particular, the Supreme Court held that it was constitutionally permissible for Congress to regulate the

amount to be paid by private companies into a sinking fund in order to ensure that the companies would have the funds to pay off their debts to the federal government upon maturity. The right of the companies to receive the full amount of funds owed them for their services to the federal government in connection with building the transcontinental railroad was not impaired. *Id.* at 721-26.

In *Bowen*, Congress expressly and unambiguously retained the " 'right to alter, amend, or repeal any provision' " of the legislation in question. 477 U.S. at 52, *quoting* 42 U.S.C. §1304. Furthermore, the Supreme Court determined that no contractual rights had been created. 477 U.S. at 52. These cases are distinguishable from the instant case, which clearly involves valid contractual rights to reinsurance payments which the defendants have not honored.

The cash recovery provisions in the instant case therefore breach the valid reinsurance contract between the parties. "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Lynch v. United States*, 292 U.S. 4571, 579 (1934). The repudiation by the federal government of a valid contract is a violation of the Due Process Clause of the Fifth Amendment unless necessary for the exercise of the federal police power or other overriding federal interests. *Id.* The Department of Education has demonstrated no important overriding interest; therefore, this Court holds that the defendants have breached their contract with the OSLC in violation of the Fifth Amendment.

The OSLC also contends that the defendants' repudiation of their contractual obligations constitutes a questioning of the public debt in violation of Section Four of the Fourteenth Amendment. "The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with

all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen." *Perry v. United States*, 294 U.S. 330, 351 (1936). Once the federal government creates binding contractual relations with another party, it is obligated to perform under the contract, and any repudiation thereof constitutes a questioning of the public debt. *Id.* Therefore, the federal government's recovery of funds which it was obligated and in fact paid to the OSLC constitutes an unconstitutional questioning of the public debt.

Therefore, the Court declares that the cash recovery provisions of 20 U.S.C. §1078(e) are in violation of the Fifth and Fourteenth Amendments to the extent they operate to withhold funds from the OSLC on reinsurance of loans originated before December 22, 1987. The defendants are hereby enjoined from further withholding of such reinsurance payments to the OSLC or any other attempt at implementing the cash recovery provisions of 20 U.S.C. §1078(e). The defendants are ordered to repay to the OSLC the funds which they have wrongfully withheld.

It is so ORDERED.

/s/ James L. Graham
JAMES L. GRAHAM
United States District Judge

DATE: December 19, 1988

GUARANTEED STUDENT LOAN PROGRAM

§ 1071. Statement of purpose; nondiscrimination; and appropriations authorized

(a) Purpose; discrimination prohibited. (1) Purpose. The purpose of this part [20 USCS §§ 1071 et seq.] is to enable the Secretary—

(A) to encourage State and nonprofit private institutions and organizations to establish adequate loan insurance programs for students in eligible institutions (as defined in section 435 [20 USCS § 1085]).

(B) to provide a Federal program of student loan insurance for students or lenders who do not have reasonable access to a State or private nonprofit program of student loan insurance covered by an agreement under section 428(b) [20 USCS § 1078(b)],

(C) to pay a portion of the interest on loans to qualified students which are insured under this part [20 USCS §§ 1071 et seq.], and

(D) to guarantee a portion of each loan insured under a program of a State or of a nonprofit private institution or organization which meets the requirements of section 428(a)(1)(B) [20 USCS § 1078-1(a)(1)(B)].

(2) Discrimination by creditors prohibited. No agency, organization, institution, bank, credit union, corporation, or other lender who regularly extends, renews, or continues credit or provides insurance under this part [20 USCS §§ 1071 et seq.] shall exclude from receipt or deny the benefits of, or discriminate against any borrower or applicant in obtaining, such credit or insurance on the basis of race, national origin, religion, sex, marital status, age, or handicapped status.

(b) Authorization of appropriations. For the purpose of carrying out this part [20 USCS §§ 1071 et seq.]—

(1) there are authorized to be appropriated to the student loan insurance fund (established by section 431 [20 USCS § 1081]) (A) the sum of $1,000,000, and (B) such further sums, if any, as may become necessary for the adequacy of the student loan insurance fund,

(2) there are authorized to be appropriated, for payments under section 428 [20 USCS § 1078] with respect to interest on student loans and for payments under section 437 [20 USCS § 1087], such sums for the fiscal year ending June 30, 1966, and succeeding fiscal years, as may be required therefor,

(3) there is authorized to be appropriated the sum of $17,500,000 for making advances pursuant to section 422 [20 USCS § 1072] for the reserve funds of State and nonprofit private student loan insurance programs,

(4) there are authorized to be appropriated (A) the sum of $12,500,000 for making advances after June 30, 1968, pursuant to section 422 (a) and (b) [20 USCS § 1072(a), (b)], and (B) such sums as may be necessary for making advances pursuant to section 422(c) [20 USCS § 1072(c)], for the reserve funds of State and nonprofit private student loan insurance programs, and

(5) there are authorized to be appropriated such sums as may be necessary for the purpose of paying an administrative cost allowance in accordance with section 428(f) [20 USCS § 1078(f)] to guaranty agencies.

Sums appropriated under paragraphs (1), (2), (4), and (5) of this subsection shall remain available until expended. No additional sums are authorized to be appropriated under paragraph (3) or (4) of this subsection by reason of the reenactment of such paragraphs by the Higher Education Amendments of 1986.

(Nov. 8, 1965, P. L. 89-329, Title IV, Part B, § 421, as added Oct. 17, 1986, P. L. 99-498, Title IV, § 402(a) in part, 100 Stat. 1353.)

§ 1078. Federal payments to reduce student interest cost

(a) Federal interest subsidies. (1) Types of loans that qualify. Each student who has received a loan for study at an eligible institution—

(A) which is insured by the Secretary under this part [20 USCS §§ 1071 et seq.]; or

(B) which is insured under a program of a State or of a nonprofit private institution or organization which was contracted for, and paid to the student, within the period specified in paragraph (5), and which—

(i) in the case of a loan insured prior to July 1, 1967, was made by an eligible lender and is insured under a program which meets the requirements of subparagraph (E) of subsection (b)(1) and provides that repayment of such loan shall be in installments beginning not earlier than 60 days after the student ceases to pursue a course of study (as described in subparagraph (D) of subsection (b)(1)) at an eligible institution, or

(ii) in the case of a loan insured after June 30, 1967, was made by an eligible lender and is insured under a program covered by an agreement made pursuant to subsection (b),

shall be entitled to have paid on his or her behalf and for his or her account to the holder of the loan a portion of the interest on such loan under circumstances described in paragraph (2).

(2) Additional requirements to receive subsidy. (A) Each student qualifying for a portion of an interest payment under paragraph (1) shall—

(i) have provided to the lender a statement from the eligible institution, at which the student has been accepted for enrollment, or at which the student is in attendance, which—

(I) sets forth such student's estimated cost of attendance (as determined under section 472 [20 USCS § 108711]; and

(II) sets forth such student's estimated financial assistance; and

(ii) meet the requirements of subparagraph (B).

(B) For the purpose of clause (ii) of subparagraph (A), a student shall qualify for a portion of an interest payment under paragraph (1) if the eligible institution has provided the lender with a statement evidencing a determination of need for a loan (as determined under part F of this title [20 USCS §§ 1087kk et seq.]) and the amount of such need, subject to the provisions of subparagraph (D).

(C) For the purpose of paragraph (1) and this paragraph—

(i) a student's estimated financial assistance means, for the period for which the loan is sought, the amount of assistance such student will receive under subpart 1 of part A [20 USCS §§ 1070a et seq.] (as determined in accordance with section 484(b) [20 USCS § 1091(b)]) subpart 2 of part A [20 USCS §§ 1070b et seq.], and parts C and E of this title [42 USCS §§ 2751 et seq.; 20 USCS §§ 1087a et seq.], and any amount paid the student under chapter 32, 34, and 35 of title 38, United States Code, plus other scholarship, grant, or loan assistance; and

(ii) the determination of need and of the amount of a loan by an eligible institution under subparagraph

(B) with respect to a student shall be calculated by subtracting from the estimated cost of attendance at the eligible institution the total of the expected family contribution with respect to such student plus any estimated financial assistance reasonably available to such student.

(D) An eligible institution may not, in carrying out the provisions of subparagraphs (A) and (B) of this paragraph, provide a statement which permits the student to receive any loan under this part [20 USCS §§ 1071 et seq.] in excess of the maximum amount applicable to such loan.

(E) For the purpose of subparagraphs (B) and (C) of this paragraph, any loan obtained by a student under section 428A [20 USCS § 1078-1] or a parent under section 428B of this Act [20 USCS § 1078-2] or under any State-sponsored or private loan program for an academic year for which the determination is made may be used to offset the expected family contribution of the student for that year.

(F) Except as provided in subparagraph (D), an eligible institution may not, in carrying out the provisions of subparagraph (A) and (B) of this paragraph, refuse to provide to any eligible lender which has an agreement under subsection (b) of this section with any guaranty agency, a statement which permits a student to receive any loan under this part [20 USCS §§ 1071 et seq.].

(3) Amount of interest subsidy. (A)(i) Subject to section 438(c) [20 USCS § 1087-1(c)], the portion of the interest on a loan which a student is entitled to have paid, on behalf of and for the account of the student, to the holder of the loan pursuant to paragraph (1) of this subsection shall be equal to the total amount of the interest on the unpaid principal amount of the loan—

(I) which accrues prior to the beginning of the repayment period of the loan, or

(II) which accrues during a period in which principal need not be paid (whether or not such principal is in fact paid) by reason of a provision described in subsection (b)(1)(M) of this section or in section 427(a)(2)(C) [20 USCS § 1077(a)(2)(C)].

(ii) Such portion of the interest on a loan shall not exceed, for any period, the amount of the interest on that loan which is payable by the student after taking into consideration the amount of any interest on that loan which the student is entitled to have paid on hi or her behalf for that period under any State or private loan insurance program.

(iii) The holder of a loan with respect to which payments are required to be made under this section shall be deemed to have a contractual right, as against the United States, to receive from the Secretary the portion of interest which has been so determined without administrative delay after the receipt by the Secretary of an accurate and complete request for payment pursuant to paragraph (4).

(iv) The Secretary shall pay this portion of the interest to the holder of the loan on behalf of and for the account of the borrower at such times as may be specified in regulations in force when the applicable agreement entered into pursuant to subsection (b) was made, or, if the loan was made by a State or is insured under a program which is not covered by such an agreement, at such times as may be specified in regulations in force at the time the loan was paid to the student.

(B) If—

(i) a State student loan insurance program is covered by an agreement under subsection (b),

(ii) a statute of such State limits the interest rate on loans by such program to a rate which is less than the applicable interest rate under this part [20 USCS §§ 1071 et seq.], and

(iii) the Secretary determines that subsection (d) does not make such statutory limitation inapplicable and that such statutory limitation threatens to impede the carrying out of the purpose of this part [20 USCS §§ 1071 et seq.],

then the Secretary may pay an administrative cost allowance to the holder of each loan which is insured under such program and which is made during the period beginning on the 60th day after the date of enactment of the Higher Education Amendments of 1968 [enacted Oct. 16, 1968] and ending 120 days after the adjournment of such State's first regular legislative session which adjourns after January 1, 1969. Such administrative cost allowance shall be paid over the term of the loan in an amount per year (determined by the Secretary) which shall not exceed 1 percent of the unpaid principal balance of the loan.

(4) Submission of statements by holders on amount of payment. Each holder of a loan with respect to which payments of interest are required to be made by the Secretary shall submit to the Secretary, at such time or times and in such manner as the Secretary may prescribe, statements containing such information as may be required by or pursuant to regulations for the purpose of enabling the Secretary to determine the amount of the payment which he must make with respect to that loan.

(5) Duration of authority to make interest subsidized loans. The period referred to in subparagraph (B) of

paragraph (1) of this subsection shall begin on the date of enactment of this Act [enacted Oct. 17, 1986] and end at the close of September 30, 1992, except that, in the case of a loan made or insured under a student loan or loan insurance program to enable a student who has obtained a prior loan made or insured under such program to continue his or her education program, such period shall end at the close of September 30, 1997.

(6) Assessment of borrower's financial condition not prohibited or required. Nothing in this or any other Act shall be construed to prohibit or require, unless otherwise specifically provided by law, a lender to evaluate the total financial situation of a student making application for a loan under this part, or to counsel a student with respect to any such loan, or to make a decision based on such evaluation and counseling with respect to the dollar amount of any such loan.

(b) Insurance program agreements to qualify loans for interest subsidies. (1) Requirements of insurance program. Any State or any nonprofit private institution or organization may enter into an agreement with the Secretary for the purpose of entitling students who receive loans which are insured under a student loan insurance program of that State, institution, or organization to have made on their behalf the payments provided for in subsection (a) if the Secretary determines that the student loan insurance program—

(A) authorizes the insurance in any academic year or its equivalent (as determined under regulations of the Secretary) for any student who is carrying at an eligible institution at least one-half the normal full-time academic workload (as determined by the institution) in any amount up to a maximum of—

(i) $2,625, in the case of a student who has not successfully completed the first or second year of a program of undergraduate education;

(ii) $4,000, in the case of a student who has successfully completed such first and second year but who has not successfully completed the remainder of a program of undergraduate education; and

(iii) $7,500, in the case of a graduate or professional student (as defined in regulations of the Secretary);

except in cases where the Secretary determines, pursuant to regulations, that a higher amount is warranted in order to carry out the purpose of this part [20 USCS §§ 1071 et seq.] with respect to students engaged in specialized training requiring exceptionally high costs of education, but the annual insurable limit per student shall not be deemed to be exceeded by a line of credit under which actual payments by the lender to the borrower will not be made in any years in excess of the annual limit;

(B) provides that the aggregate insured unpaid principal amount for all such insured loans made to any student shall be any amount up to a maximum of—

(i) $17,250, in the case of any student who has not successfully completed a program of undergraduate education; and

(ii) $54,750, in the case of any graduate or professional student (as defined by regulations of the Secretary and including any loans which are insured by the Secretary under this part [20 USCS §§ 1071 et seq.], or by a guaranty agency, made to such student before the student became a graduate or professional student);

except that the Secretary may increase the limit applicable to students who are pursuing programs which the Secretary determines are exceptionally expensive;

(C) authorizes the insurance of loans to any individual student for at least 6 academic years of study or their

equivalent (as determined under regulations of the Secretary);

(D) provides that (i) the student borrower shall be entitled to accelerate without penalty the whole or any part of an insured loan, (ii) except as provided in subparagraph (M) of this paragraph, the repayment period of any insured loan may not exceed 10 years, and (iii) the note or other written evidence of any loan, may contain such reasonable provisions relating to repayment in the event of default by the borrower as may be authorized by regulations of the Secretary in effect at the time such note or written evidence was executed;

(E) subject to subparagraph (D) and (L) of this paragraph and except as provided by subparagraph (M) of this paragraph, provides that repayment of loans shall be in installments over a period of not less than 5 years (unless the student, during the 6 months preceding the start of the repayment period, specifically requests that repayment be made over a shorter period) nor more than 10 years beginning 6 months after the month in which the student ceases to carry at one-half the normal full-time academic workload as determined by the institution;

(F) authorizes interest on the unpaid balance of the loan at a yearly rate not in excess (exclusive of any premium for insurance which may be passed on to the borrower) of the rate required by section 427A [20 USCS § 1077a];

(G) insures not less than 100 percent of the unpaid principal of loans insured under the program;

(H) provides for collection of a single insurance premium equal to not more than 3 percent of the principal amount of the loan, by deduction proportionately from each installment payment of the proceeds of the

loan to the borrower, and insures that the proceeds of the premium will not be used for incentive payments to lenders;

(I) provides that the benefits of the loan insurance program will not be denied any student who is eligible for interest benefits under subsection (a)(1) and (2);

(J) provides that a student may obtain insurance under the program for a loan for any year of study at an eligible institution;

(K) in the case of a State program, provides that such State program is administered by a single State agency, or by one or more nonprofit private institutions or organizations under supervision of a single State agency;

(L) provides that the total of the payments by borrower—

(i) during any year of any repayment period with respect to the aggregate amount of all loans to that borrower which are insured under this part [20 USCS §§ 1071 et seq.] shall not, unless the borrower and the lender otherwise agree, be less than $600 or the balance of all such loans (together with interest thereon), whichever amount is less, except that, in the case of a husband and wife, both of whom have such loans outstanding, the total of the combined payments for such a couple during any year shall not be less than $600 or the balance of all such loans, whichever is less; and

(ii) for a monthly or other similar payment period with respect to the aggregate of all loans held by the lender may, when the amount of a monthly or other similar payment is not a multiple of $5, be rounded to the next highest whole dollar amount that is a multiple of $5;"

(M) provides the periodic installments of principal need not be paid, but interest shall accrue and be paid, during any period—

(i) during which the borrower (I) is pursuing a full-time course of study as determined by an eligible institution, (II) is pursuing at least a half-time course of study (as determined by such institution) for which the student has obtained a loan under this part [20 USCS §§ 1071 et seq.], or (III) is pursuing a course of study pursuant to a graduate fellowship program approved by the Secretary, or pursuant to a rehabilitation training program for disabled individuals approved by the Secretary;

(ii) not in excess of 3 years during which the borrower is a member of the Armed Forces of the United States, is an active duty member of the National Oceanic and Atmospheric Administration Corps, or is an officer of the Commissioned Corps of the Public Health Service;

(iii) not in excess of 3 years during which the borrower is in service as a volunteer under the Peace Corps Act;

(iv) not in excess of 3 years during which the borrower is in service as a full-time volunteer under the Domestic Volunteer Service Act of 1973;

(v) not in excess of 3 years during which the borrower is in service, comparable to the service referred to in clauses (iii) and (iv), as a full-time volunteer for an organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1954;

(vi) not in excess of 3 years during which the borrower is engaged as a full-time teacher in a public or private elementary or secondary school in a

teacher shortage area established by the Secretary pursuant to paragraph (4) of this subsection;

(vii) not in excess of 2 years during which the borrower is serving an internship, the successful completion of which is required in order to receive professional recognition required to begin professional practice or service;

(viii) not in excess of 3 years during which the borrower is temporarily totally disabled, as established by sworn affidavit of a qualified physician, or during which the borrower is unable to secure employment by reason of the care required by a dependent who is so disabled;

(ix) not in excess of 24 months, at the request of the borrower, during which the borrower is seeking and unable to find full-time employment;

(x) not in excess of 6 months of parental leave; and

(xi) not in excess of 12 months for mothers with preschool age children who are just entering or reentering the work force and who are compensated at a rate not exceeding $1 in excess of the rate prescribed under section 6 of the Fair Labor Standards Act of 1938;

(N) provides that funds borrowed by a student are disbursed to the institution by check or other means that is payable to and requires the endorsement or other certification by such student, except nothing in this title shall be interpreted to allow the Secretary to require checks to be made co-payable to the institution and the borrower or to prohibit the disbursement of loan proceeds by means other than by check;

(O) provides that the proceeds of any loan made for any period of enrollment that ends more than 180 days (or 6 months) after the date disbursement is

scheduled to occur, and for an amount of more than $1,000—

(i) will be disbursed directly by the lender in two or more installments, none of which exceeds one-half of the loan, with the second installment being dispensed after not less than one-third of such period (except as necessary to permit the second installment to be disbursed at the beginning of the second semester, quarter, or similar division of such period of enrollment), or

(ii) will be disbursed in such installments pursuant to the escrow provisions of subsection (i) of this section,

but all loans issued for the same period of enrollment shall be considered as a single loan for the purpose of this subparagraph and the requirements of this subparagraph shall not apply in the case of a loan made under section 428A, 428B, or 428C [20 USCS § 1078-1, 1078-2, or 1078-3], or made to a student to cover the cost of attendance at an eligible institution outside the United States;

(P) requires the borrower and the institution at which the borrower is in attendance to promptly notify the holder of the loan, directly or through the guaranty agency, concerning any changes of address or status;

(Q) provides for the guarantee of loans made to students and parents under sections 428A and 428B [20 USCS §§ 1078-1, 1078-2];

(R) with respect to lenders which are eligible institutions, provides for the insurance of loans by only such institutions as are located within the geographic area served by such guaranty agency;

(S) provides no restrictions with respect to the insurance of loans for students who are otherwise eli-

gible for loans under such program if such a student is accepted for enrollment in or is attending an eligible institution within the State, or if such a student is a legal resident of the State and is accepted for enrollment in or is attending an eligible institution outside that State;

(T) provides no restrictions with respect to eligible institutions which are more onerous than eligibility requirements for institutions under the Federal student loan insurance program as in effect in January 1, 1985, unless—

(i) that institution is ineligible under regulations for the limitation, suspension, or termination of eligible institutions under the Federal student loan insurance program or is ineligible pursuant to criteria issued under the student loan insurance program which are substantially the same as regulations with respect to such eligibility issued under the Federal student loan insurance program; or

(ii) there is a State constitutional prohibition affecting the eligibility of such an institution; and

(U) provides (i) for the eligibility of all lenders described in section 435(d)(1) [20 USCS § 1085(d)(1)] under reasonable criteria, unless (I) that lender is eliminated as a lender under regulations for the limitation, suspension, or termination of a lender under the Federal student loan insurance program or is eliminated as a lender pursuant to criteria issued under the student loan insurance program which are substantially the same as regulations with respect to such eligibility as a lender issued under the Federal student loan insurance program, or (II) there is a State constitutional prohibition affecting the eligibility of a lender, and (ii) assurance that the guaranty agency will report to the Secretary concerning changes in

such criteria, including any procedures in effect under such program to limit, suspend, or terminate lenders.

(2) Contents of insurance program agreement. Such an agreement shall—

(A) provide that the holder of any such loan will be required to submit to the statements containing such information as may be required by or pursuant to regulation for the purpose of enabling the Secretary to determine the amount of the payment which must be made with respect to that loan;

(B) include such other provisions as may be necessary to protect the United States from the risk of unreasonable loss and promote the purpose of this part [20 USCS §§ 1071 et seq.], including such provisions as may be necessary for the purpose of section 437 [20 USCS § 1087], and as are agreed to by the Secretary and the guaranty agency, as the case may be;

(C) provide for making such reports, in such form and containing such information, as the Secretary may reasonably require to carry out the Secretary's functions under this part [20 USCS §§ 1071 et seq.], and for keeping such records and for affording such access thereto as the Secretary may find necessary to assure the correctness and verification of such reports;

(D) provide for—

(i) conducting, except as provided in clause (ii), financial and compliance audits of the guaranty agency at least once every 2 years and covering the period since the most recent audit, conducted by a qualified, independent organization or person in accordance with standards established by the Comptroller General for the audit of governmental organizations, programs, and functions, and as prescribed in regulations of the Secretary, the results of which shall be submitted to the Secretary; or

(ii) with regard to a guaranty program of a State which is audited under chapter 75 of title 31, United States Code, deeming such audit to satisfy the requirements clause (i) for the periods of time covered by such audit and;

(E) provide that any guaranty agency may transfer loans which are insured under this part to any other guaranty agency which the approval of the holder of the loan and such other guaranty agency.

(3) Restrictions on inducements, mailings, and advertising. A guaranty agency shall not—

(A) offer, directly or indirectly, premiums, payments, or other inducements to any educational institution or its employees in order to secure applicants for loans under this part [20 USCS §§ 1071 et seq.];

(B) conduct unsolicited mailings to students enrolled in secondary school of student loan application forms; or

(C) conduct fraudulent or misleading advertising concerning loan availibility.

(4) Targeted teacher deferment rule. (A) The deferment for services as a teacher in a public or nonprofit private elementary or secondary school shall be for service as such a teacher in shortage areas prescribed by the Secretary, in consultation with the chief State school officer or, in the case of nonprofit private elementary or secondary schools, with appropriate officials of the nonprofit private schools in each State in accordance with this subparagraph.

(B) For the purpose of this paragraph, the term "shortage areas" means (i) geographic areas of the State in which there is a shortage of elementary and secondary school teachers, and (ii) an area of shortage of elementary and secondary school teachers in spe-

cific grade levels and in specific academic, instructional, subject matter, and discipline classification. In carrying out the provisions of this subparagraph, the Secretary shall give special consideration to areas in which emergency certification of individuals in a State is being used to correct teachers shortages; and to States which have retirement laws permitting early retirement.

(5) Special rule. For the purpose of paragraph (1)(M) of this subsection, the Secretary shall approve any course of study at a foreign university that is accepted for the completion of a recognized international fellowship program by the administrator of such a program.

(6) Guaranty agency information transfers. (A) Prior to the implementation of section 485B [20 USCS § 1092b], any guaranty agency may request information regarding loans made after January 1, 1987, to students who are residents of the State for which the agency is the designated guarantor, from any other guaranty agency insuring loans to such students.

(B) Upon a request pursuant to subparagraph (A), a guaranty agency shall provide—

(i) the name and the social security number of the borrower; and

(ii) the amount borrowed, the cumulative amount borrowed, the income reported on the loan application, and the purposes and the cost of attendance of the borrower.

(C) Any costs associated with fulfilling the request of a guaranty agency for information on students shall be paid by the guaranty agency requesting the information.

(c) **Guaranty agreements for reimbursing losses.** (1) A authority to enter into agreements. (A) The Secretary

may enter into a guaranty agreement with any guaranty agency, whereby the Secretary shall undertake to reimburse it, under such terms and conditions as the Secretary may establish, with respect to losses (resulting from the default of the student borrower) on the unpaid balance of the principal and accrued interest of any insured loan, including the administrative costs of supplemental preclaim assistance for default prevention as defined in paragraph (6)(C). The guaranty agency shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection. Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in paragraph (7), the amount to be paid a guaranty agency as reimbursement under this subsection shall be equal to 100 percent of the amount expended by it in discharge of its insurance obligation incurred under its loan insurance program. In no case shall a guaranty agency file a claim under this subsection for reimbursement with respect to losses prior to 270 days after the loan becomes delinquent with respect to any installment thereon.

(B) Notwithstanding subparagraph (A)—

(i) if, for any fiscal year, the amount of such reimbursement payments by the Secretary under this subsection exceeds 5 percent of the loans which are insured by such guaranty agency under such program and which were in repayment at the end of the preceding fiscal year, the amount to be paid as reimbursement under this subsection for such excess shall be equal to 90 percent of the amount of such excess; and

(ii) if, for any fiscal year, the amount of such reimbursement payments exceeds 9 percent of such loans, the amount to be paid as reimbursement under this subsection for such excess shall be equal to 80 percent of the amount of such excess.

(C) For the purpose of this subsection, the amount of loans of a guaranty agency which are in repayment shall be the original principal amount of loans made by a lender which are insured by such a guaranty agency reduced by—

(i) the amount the insurer has been required to pay to discharge its insurance obligations under this part [20 USCS §§ 1071 et seq.];

(ii) the original principal amount of loans insured by it which have been fully repaid; and

(iii) the original principal amount insured on those loans for which payment of the first installment of principal has not become due pursuant to subsection (b)(1)(E) of this section or such first installment need not be paid pursuant to subsection (b)(1)(M) of this section.

(2) Contents of guaranty agreements. The guaranty agreement—

(A) shall set forth such administrative and fiscal procedures as may be necessary to protect the United States from the risk of unreasonable loss thereunder, to ensure proper and efficient administration of the loan insurance program, and to assure that due diligence will be exercised in the collection of loans insured under the program, including a requirement that each beneficiary of insurance on the loan submit proof that reasonable attempts were made to locate the borrower (when the location of the borrower is unknown) and proof that contact was made with the borrower (when the location is known);

(B) shall provide for making such reports, in such form and containing such information, as the Secretary may reasonably require to carry out the Secretary's functions under this subsection, and for keeping such records and for affording such access thereto as the Secretary may find necessary to assure the correctness and verification of such reports;

(C) shall set forth adequate assurance that, with respect to so much of any loan insured under the loan insurance program as may be guaranteed by the Secretary pursuant to this subsection, the undertaking of the Secretary under the guaranty agreement is acceptable in full satisfaction of State law or regulation requiring the maintenance of a reserve;

(D) shall provide that if, after the Secretary has made payment under the guaranty agreement pursuant to paragraph (1) of this subsection with respect to any loan, any payments are made in discharge of the obligation incurred by the borrower with respect to such loan (including any payments of interest accruing on such loan after such payment by the Secretary), there shall be paid over to the Secretary (for deposit in the fund established by section 431 [20 USCS § 1081]) such proportion of the amounts of such payments as is determined (in accordance with paragraph (6)) to represent his equitable share thereof, but (i) shall provide for subrogation of the United States to the rights of any insurance beneficiary only to the extent required for the purpose of paragraph (8); and (ii) except as the Secretary may otherwise by or pursuant to regulation provide, amounts so paid by a borrower on such a loan shall be first applied in reduction of principal owing on such loan;

(E) shall set forth adequate assurance that an amount equal to each payment made under paragraph (1) will be promptly deposited in or credited to the accounts

maintained for the purpose of section 422(c) [20 USCS § 1072(c)];

(F) set forth adequate assurances that the guaranty agency will not engage in any pattern or practice which results in a denial of a borrower's access to loans under this part because of the borrower's race, sex, color, religion, national origin, age, handicapped status, income, attendance at a particular eligible institution within the area served by the guaranty agency, length of the borrower's educational program, or the borrower's academic year in school; and

(G) may include such other provisions as may be necessary to promote the purpose of this part [20 USCS §§ 1071 et seq.].

(3) Forbearance. To the extent provided in regulations of the Secretary, a guaranty agreement under this subsection may contain provisions which permit such forbearance for the benefit of the student borrower as may be agreed upon by the parties to an insured loan and approved by the insurer. Such regulations shall not preclude guaranty agencies from permitting the parties to such a loan from entering into a forbearance agreement solely because the loan is in default.

(4) Definitions. For the purpose of this subsection, the terms "insurance beneficiary" and "default" have the meanings assigned to them by section 435.

(5) Applicability to existing loans. In the case of any guaranty agreement with a guaranty agency, the Secretary may, in accordance with the terms of this subsection, undertake to guarantee loans described in paragraph (1) which are insured by such guaranty agency and are outstanding on the date of execution of the guaranty agreement, but only with respect to defaults occurring after the execution of such guaranty agreement or, if later, after its effective date.

(6) Secretary's equitable share. (A) For the purpose of paragraph (2)(D), the Secretary's equitable share of payments made by the borrower shall be that portion of the payments remaining after the guaranty agency with which the Secretary has an agreement under this subsection has deducted from such payments—

(i) a percentage amount equal to the complement of the reinsurance percentage in effect when payment under the guaranty agreement was made with respect to the loan; and

(ii) an amount equal to 30 percent of such payment (subject to subparagraph (D) of this paragraph) for costs related to the student loan insurance program, including the administrative costs of collection of loans reimbursed under this subsection, the administrative costs of preclaims assistance for default prevention, the administrative costs of supplemental preclaims assistance for default prevention, and the administrative costs of monitoring the enrollment and repayment status of students (as such terms are defined in subparagraph (B) or (C) of this paragraph).

(B) For the purpose of this paragraph and subsection (f) of this section, the term—

(i) "administrative costs of collection of loans" means any administrative costs incurred by a guaranty agency which are directly related to the collection of the loan on which a default claim has been paid to the participating lender, including the attributable compensation of collection personnel (and in the case of personnel who perform several functions for such an agency only the portion of the compensation attributable to the collection activity), attorney's fees, fees paid to collection agencies, postage, equipment, supplies, telephone and

similar charges, but does not include the overhead costs of such agency whether or not attributable;

(ii) "administrative costs of preclaim assistance for default prevention" means any administrative costs incurred by a guaranty agency which are directly related to providing collection assistance to the lender on a delinquent loan, prior to the loan's being legally in a default status, including the attributable compensation of appropriate personnel (and in the case of personnel who perform several functions for such an agency only the portion of compensation attributable to the collection activity), fees paid to locate a missing borrower, postage, equipment, supplies, telephone and similar charges, but does not include the overhead costs of such agency whether or not attributable; and

(iii) "administrative costs of monitoring the enrollment and repayment status of students" means any administrative costs by a guaranty agency which are directly related to ascertaining the student's enrollment statutes, prompt notification to the lender of such status, an audit of the note or written agreement to determine if the provisions of that note or agreement are consistent with the records of the guaranty agency as to the principal amount of the loan guaranteed, and an examination of the note or agreement to assure that the repayment provisions are consistent with the provisions of this part [20 USCS §§ 1071 et seq.],

subject to such additional criteria as the Secretary may by regulation prescribe.

(C)(i) For the purpose of this paragraph, "administrative costs of supplemental preclaims assistance" means (subject to divisions (ii) through (iv)) any administrative costs—

(I) incurred by a guaranty agency in connection with a loan on which the guarantor has exercised preclaims assistance required or permitted under paragraph (2)(A) of this subsection and subsection (f), and which has been in delinquent status for at least 120 days; and

(II) which are directly related to providing collection assistance to the lender on a delinquent loan, prior to a claim being filed with the guaranty agency,

including the attribute compensation of appropriate personnel (and the case of personnel who perform several functions, only the portion of compensation attributable to the collection assistance), fees paid to locate a missing borrower, postage, equipment, supplies, telephone, and similar charges, but does not include overhead costs.

(ii) The administrative costs for which reimbursement is authorized under this subparagraph must be clearly supplemental to the preclaim assistance for default prevention which the guaranty agency is required or permitted to provide pursuant to paragraph (2)(A) of this subsection and subsection (f).

(iii) The services associated with carrying out this subparagraph may be provided by the guaranty agency directly or under contract, except that such services may not be carried out by an organization or entity (other than the guaranty agency)—

(I) that is the holder or servicer of the loan or an organization or entity that owns or controls the holder or servicer of the loan;

(II) that is owned or controlled by the same corporation, partnership, association, or individual that owns or controls the holder or servicer of the loan; or

(III) that is an organization or entity that has a contract with a guaranty agency to perform collection activities with respect to the same loans in the event of default.

(iv) The costs for each delinquent loan associated with carrying out this subparagraph may not exceed 2 percent of the outstanding principal balance of each such loan subject to the supplemental preclaims assistance authorized by this subparagraph or $100, whichever is less.

(D) In the case of a State which enacts a garnishment law that complies with the requirements of section 428E [20 USCS § 1078-5], subparagraph (A)(ii) shall be applied by substituting "35 percent" for "30 percent".

(7) New programs eligible for 100 percent reinsurance. (A) Notwithstanding paragraph (1)(B), the amount to be paid a guaranty agency for any fiscal year—

(i) which begins on or after October 1, 1977; and

(ii) which is either the fiscal year in which such guaranty agency begins to actively carry on a student loan insurance program which is subject to a guaranty agreement under subsection (b) of this section, or is one of the 4 succeeding fiscal years,

shall be 100 percent of the amount expended by such guaranty agency in discharge of its insurance obligation insured under such program.

(B) The Secretary shall continuously monitor the operations of those guaranty agencies to which the provisions of subparagraph (A) are applicable and revoke the application of such subparagraph to any such guaranty agency which the Secretary determines has not exercised reasonable prudence in the administration of such program.

(8) Assignment to protect federal fiscal interest. If the Secretary determines that the protection of the Federal fiscal interest so requires, a guaranty agency shall assign to the Secretary any loan of which it is the holder and for which the Secretary has made a payment pursuant to paragraph (1) of this subsection.

(9) Reinsurance fees. (A) Any guaranty agency which has entered into an agreement with the Secretary pursuant to this subsection shall pay to the Secretary during each fiscal year a reinsurance fee in an amount equal to—

(i) 0.25 percent of the total principal amount of the loans upon which insurance was issued by such agency during such fiscal year, in any fiscal year other than a fiscal year described in clause (ii); or

(ii) 0.5 percent of the total principal amount of the loans upon which insurance was issued by such agency during such fiscal year, in any fiscal year with respect to which the Secretary reimbursed the agency for any losses (resulting from the default of the borrower) pursuant to paragraph (1)(B) of this subsection.

(B) The amount to be paid pursuant to subparagraph (A) may be paid from any funds available to the guaranty agency.

(C) When the Secretary first reimburses a guaranty agency pursuant to paragraph (1)(B) of this subsection, the Secretary shall notify such agency of the exact date of such reimbursement.

(d) Usury laws inapplicable. No provision of any law of the United States (other than this Act) or of any State (other than a statute applicable principally to such State's student loan insurance program) which limits the rate or amount of interest payable on loans shall apply to a loan—

(1) which bears interest (exclusive of any premium for insurance) on the unpaid principal balance at a rate not in excess of the rate specified in this part [20 USCS §§ 1701 et seq.]; and

(2) which is insured (i) by the United States under this part [20 USCS §§ 1071 et seq.], or (ii) by a guaranty agency under a program covered by an agreement made pursuant to subsection (b) of this section.

(e) Payments for lender referral services. (1) In general. The Secretary shall make payments in accordance with this paragraph to a guaranty agency in any State which provides a lender referral service for students who meet the requirements of paragraph (2).

(2) Student eligibility. A student is eligible to apply for lender referral services to a guaranty agency in a State if—

(A) such student is either a resident of such State or is accepted for enrollment in or is attending an eligible institution in such State; and

(B) such student has sought and was unable to find a lender willing to make a loan under this part [20 USCS §§ 1071 et seq.].

(3) Amount of payment. The amount which the Secretary shall pay to any eligible guaranty agency under this paragraph shall be equal to one-half of 1 percent of the total principal amount of the loan (upon which insurance was issued under this part) to a student described in paragraph (2) who subsequently obtained such loans because of such agency's referral service.

(4) Incentive fees to lenders. Nothing in this or any law shall prohibit an agency from using all or any portion of the funds received under this part for the payment of incentive fees to lenders who agree to participate in a lender referral service.

(5) Authorization of appropriations. There is authorized to be appropriated such sums as are necessary to carry out the provisions of this paragraph.

(f) Payments of certain costs. (1) Payments based on insurance program agreement. (A) The Secretary shall make payments in accordance with the provisions of this paragraph to any guaranty agency for the purposes of—

(i) the administrative costs of promotion of commercial lender participation;

(ii) the administrative costs of collection of loans;

(iii) the administrative costs of preclaims assistance for default prevention;

(iv) the administrative costs of monitoring the enrollment and repayment status of students; or

(v) other such costs related to the student loan insurance program subject to such agreement.

(B) The total amount of payments for any fiscal year made under this paragraph shall be equal to 1 percent of the total principal amount of the loans upon which insurance was issued under this part [20 USCS §§ 1071 et seq.] during such fiscal year by such guaranty agency. The guaranty agency shall be deemed to have a contractual right against the United States to receive payments according to the provisions of ths subparagraph. Payments shall be made promptly and without administrative delay to any guaranty agency submitting an accurate and complete application therefor under this subparagraph.

(2) Applications for payment. No payment may be made under paragraph (1) of this subsection unless the guaranty agency submits to the Secretary an application at such time, at least annually, in such manner, and containing or accompanied by such information, as the Sec-

retary may reasonably require. Each such application shall—

(A) set forth assurances that the student loan insurance program subject to the guaranty agreement complies with subparagraphs (A), (B), (G), (R), (S), (T), and (U) of subsection (b)(1);

(B) contain provisions designed to demonstrate the capability of carrying out a necessary and successful program of collection of and preclaim assistance for the loan program subject to that agreement;

(C) set forth an estimate of the costs which are eligible for payment under the provisions of this subsection;

(D) provide for such administrative and fiscal procedures, including an audit, as are necessary to carry out the provisions of this subsection; and

(E) set forth assurances that the guaranty agency will furnish such data and information, including where necessary estimates, as the Secretary may reasonably require, to carry out the provisions of this subsection.

(g) Action on insurance program and guaranty agreements. If a nonprofit private institution or organization—

(1) applies to enter into an agreement with the Secretary under subsections (b) and (c) with respect to a student loan insurance program to be carried on in a State with which the Secretary does not have an agreement under subsection (b), and

(2) as provided in the application, undertakes to meet the requirements of section 422(c)(6)(B)(i), (ii), and (iii) [20 USCS § 1072(c)(6)(B)(i), (ii), (iii)],

the Secretary shall consider and act upon such application within 180 days, and shall forthwith notify the Committee on Labor and Human Resources of the senate and the

Committee on Education and Labor of the House of Representatives of his actions.

(h) Lending by guaranty agencies. (1) Lending from sallie mae advances. From sums advanced by the Association pursuant to section 439(p) [20 USCS § 1087-2(p)], each guaranty agency or an eligible lender in a State described in section 435(d)(1)(D) or (F) of the Act [20 USCS § 1085(d)(1)(D) or (F)] is authorized to make loans directly to students otherwise unable to obtain loans under this part [20 USCS §§ 1071 et seq.].

(2) Amount of advances. (A) Each guaranty agency or an eligible lender in a State described in section 435(d)(1)(D) or (F) [20 USCS § 1085(d)(1)(D) or (F)] which has an application approved under section 439(p)(2) [20 USCS § 1087-2(p)(2)] may receive advances under section 439(p) [20 USCS § 1087-2(p)] for each fiscal year in an amount necessary to meet the demand for loans under this section. The amount such agency or lender is eligible to receive may not exceed 25 percent of the average of the loans guaranteed by that agency or lender for the 3 years preceding the fiscal year for which the determination is made. Whenever the determination required by the preceding sentence cannot be made because the agency or lender does not have 3 years previous experience, the amount such agency or lender is eligible to receive may not exceed 25 percent of the loans guaranteed under a program of a State of comparable size.

(B) Each guaranty agency and each eligible lender in a State described in section 435(d)(1)(D) or (F) [20 USCS § 1085(d)(1)(D) or (F)] shall repay advances made under section 439(p) [20 USCS § 1087-2(p)] in accordance with agreements entered into between the Association and such agency or lender.

(3) Loan term, conditions, and benefits. Loans made pursuant to this subsection shall have the same terms, con-

ditions, and benefits as all other loans made under this part [20 USCS §§ 1071 et seq.].

(i) Multiple disbursement of loans. (1) Escrow accounts administered by escrow agent. Any guaranty agency or eligible lender (hereafter in this subsection referred to as the "escrow agent") may enter into an agreement with any other eligible lender that is not an eligible institution or an agency or instrumentality of the State (hereafter in this subsection referred to as the "lender") for the purpose of authorizing multiple disbursements of the proceeds of a loan to a student. Such agreement shall provide that the lender will pay the proceeds of such loans into an escrow account to be administered by the escrow agent in accordance with the provisions of paragraph (2) of this subsection. Such agreement may allow the lender to make payments into the escrow account in amounts that do not exceed the sum of the amounts required for disbursement of initial or subsequent installments to borrowers and to make such payments not more than 45 days prior to the date of the disbursement of such installment to such borrowers. Such agreement shall require the lender to notify promptly the eligible institution when funds are escrowed under this subsection for a student at such institution.

(2) Authority of escrow agent. Each escrow agent entering into an agreement under paragraph (1) of this subsection is authorized to—

(A) make the disbursements in accordance with the note evidencing the loan;

(B) commingle the proceeds of all loans paid to the escrow agent pursuant to the escrow agreement entered into under such paragraph (1);

(C) invest the proceeds of such loans in obligations of the Federal Government or obligations which are insured or guaranteed by the Federal Government;

(D) retain interest or other earnings on such investment; and

(E) return to the lender undisbursed funds when the student ceases to carry at an eligible institution at least one-half of the normal full-time academic workload as determined by the institution.

(j) Lenders-of-last-resort. In each State, the guaranty agency or an eligible lender in the State described in section 435(d)(1)(D) of this Act [20 USCS § 1085(d)(1)(D)] shall make loans directly, or through an agreement with an eligible lender or lenders, to students eligible to receive interest benefits paid on their behalf under subsection (a) of this section who are otherwise unable to obtain loans under this part [20 USCS §§ 1071 et seq.]. Loans made under this subsection shall not exceed the amount of the need of the borrower, as determined under subsection (a)(2)(B), nor be less than $200.

(k) Information on defaults. (1) Provision of information to eligible institutions. In order to notify eligible institutions of former students who are in default of their continuing obligation to repay student loans, each guaranty agency may, upon the request of an eligible institution, furnish information with respect to students who were enrolled at the eligible institution and who are in default on the repayment of any loan made, insured, or guaranteed under this part [20 USCS §§ 1071 et seq.]. The information authorized to be furnished under this subsection may include the names and addresses of such students.

(2) Public dissemination not authorized. Nothing in paragraph (1) of this subsection shall be construed to authorize public dissemination of the information described in paragraph (1).

(Nov. 8, 1965, P. L. 89-329, Title IV, Part B, § 428, as added Oct. 17, 1986, P. L. 99-498, Title IV, § 402(a) in part, 100 Stat. 1367.)

UNITED STATES CONSTITUTION, AMENDMENT XIV

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Section 2. Representatives shall be apportioned among the several States according to their respective numbers, counting the whole number of persons in each State, excluding Indians not taxed. But when the right to vote at any election for the choice of electors for President and Vice President of the United States, Representatives in Congress, the Executive and Judicial officers of a State, or the members of the Legislature thereof, is denied to any of the male inhabitants of such State, being twenty-one years of age, and citizens of the United States, or in any way abridged, except for participation in rebellion, or other crime, the basis of representation therein shall be reduced in the proportion which the number of such male citizens shall bear to the whole number of male citizens twenty-one years of age in such State.

Section 3. No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the United States, or under any State, who having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any State legislature, or as an executive or judicial officer of any State, to support the constitution of the United States, shall have engaged in insurrection or rebellion against the same, or

given aid or comfort to the enemies thereof. But Congress may by a vote of two-thirds of each House, remove such disability.

Section 4. The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

Section 5. The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

UNITED STATES CONSTITUTION, AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

PUB. L. NO. 100-203, 101 STAT. 1330-36

SEC. 3001. RECOVERY OF EXCESS CASH RESERVES ACCUMULATED UNDER THE GUARANTEED STUDENT LOAN PROGRAM

(a) IN GENERAL—Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is amended by adding at the end thereof the following new subsection:

"(e) REDUCTION OF EXCESS CASH RESERVES.—

"(1) LIMITATION ON MAXIMUM CASH RESERVES—A guaranty agency shall not accumulate cash reserves in excess of the greater of—

"(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;

"(B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;

"(C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;

"(D) $500,000; or

"(E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

"(2) RECOVERY OF EXCESS CASH RESERVES.—The Secretary shall, not later than March 31, 1988, determine for each guaranty agency the maximum cash reserve permitted under paragraph (1) for fiscal year 1986. Subject to paragraphs (3) and (4), if the Secretary determines that any guaranty agency had, at the end of fiscal year 1986, a cash

reserve that exceeded such maximum, the Secretary shall direct the agency to eliminate such excess by any one or more of the following methods, as selected by the guaranty agency:

"(A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d);

"(B) by withholding and canceling claims for reimbursement otherwise payable under section 428(c)(1);

"(C) by reducing the amount of payments for which application will be made by such agency under section 428(f); or

"(D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 428(c)(9), as proposed by the agency and agreed to by the Secretary.

"(3) APPEALS BASED ON SPECIAL CIRCUMSTANCES.—(A) If the Secretary determines, on the basis of an application from a guaranty agency, that—

"(i) the agency's financial position has deteriorated significantly since the end of the preceding fiscal year;

"(i) significant changes in the economic circumstances (such as a change in agency current cash reserves) or the loan insurance program render the limitations of paragraph (1) inadequate for the continued functioning of the agency; or

"(iii) in recovering funds as required by this subsection, a guaranty agency would be compelled to violate contractual obligations existing on the date

of enactment of this subsection that require a specified level of reserve funds to be maintained by such agency;

the Secretary may waive, in whole or in part, the imposition of the remedies required by paragraph (2) for such agency.

"(B) The Secretary shall respond to request for waivers from guaranty agencies in an expedited manner and, except for unusual circumstances or with the consent of the guaranty agency, shall resolve such request within 6 weeks of submission.

"(4) RECOVERY LIMITS. - The Secretary shall not require a total reduction of cash reserves for all guaranty agencies in excess of $250,000,000 during fiscal year 1988. If the total of cash reserves of all guaranty agencies exceeds the maximum amounts permitted under paragraph (1) by more than $250,000,000, the Secretary shall ratably reduce the amounts that guaranty agencies are directed to eliminate under paragraph (2), so that the total excess cash reserves to be eliminated equals $250,000,000.

"(5) DEFINITIONS.—As used in this subsection—

"(A) the 'cash reserves' for any guaranty agency for any fiscal year are equal to the agency's cumulative cash receipts less the agency's cumulative cash disbursements at the end of such fiscal year;

"(B) the 'total reserves' for any guaranty agency for any fiscal year are equal to the agency's cash reserves plus the agency's cumulative accounts receivable less the agency's accounts payable, as of the end of such fiscal year;

"(C) the term 'cumulative cash receipts' includes such receipts as insurance premiums, Federal reinsurance payments, and collections on defaulted loans;

"(D) the term 'cumulative cash disbursements' includes such disbursements as payments for default claims, repayment of Federal advances, transfers to other State activities, and payment of collection costs and other operating costs;

"(E) the term 'accounts receivable' includes Federal reinsurance payments and administrative cost allowances owed but not yet paid to the guaranty agency, as of the end of a fiscal year; and

"(F) the term 'accounts payable' includes collections and reinsurance fees due (but not paid) to the Department of Education, as of the end of a fiscal year.".

(b) CONFORMING AMENDMENTS.—

(1) The second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

(2) Section 428(c)(9)(A) of such Act is amended by striking out "an amount equal to" and inserting "an amount, subject to section 422(e), equal to".

(3) The second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

SEC. 3002. REPEAL

(a) IN GENERAL.—Subsection (e) of Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is repealed on September 30, 1989.

(b) CONFORMING AMENDMENTS.—

(1) Effective September 30, 1989, the second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

(2) Effective September 30, 1989, section 428(c)(9)(A) of such Act is amended by striking out "an amount, subject to section 422(e), equal to" and inserting "an amount equal to".

(3) Effective September 30, 1989, the second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".